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OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

WRITTEN COMMENTS

ON

DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

APRIL 21, 1988

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FOR IMMEDIATE RELEASE
THURSDAY, MARCH 31, 1988

PRESS RELEASE #16
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THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES ANNOUNCES SUBCOMMITTEE REQUEST FOR PUBLIC COMMENTS ON DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, today announced the release of the Subcommittee's preliminary discussion options regarding the unrelated business income tax (UBIT). The list of discussion options is a follow-up to the Subcommittee's series of hearings held in June, 1987.

The Subcommittee is interested in receiving comments from the public on the options set forth below. The Subcommittee requests that such comments be provided in writing, **no later than April 15, 1988**. Written comments received by the Subcommittee will provide a basis for the Subcommitee's development of UBIT recommendations to the full Committee. (Committee rules on page 4 for "Submission of Written Comments" must be followed.) A Subcommittee hearing is expected to be scheduled in late April, following this comment period, to receive testimony from a limited number of invited witnesses. (Details will be provided in a subsequent press release.)

In announcing the Subcommittee's request for public comments, Chairman Pickle stated: "The Subcommittee Members met this week and agreed that public comments should be received on a broad series of options on the unrelated business income tax. This should be done before any Subcommittee decisions are made in the area. The discussion options are not specific recommendations, but serve as the generally agreed to starting point for the Subcommittee's discussion. We recognize the very strong and appropriate concerns both of tax-exempt organizations and the business community in this sensitive area of our tax law. We look forward to constructive and detailed comments by all interested parties."

The Subcommittee's discussion options are the following:

I. "Substantially Related" Test:

Repeal "substantially related" test and replace it with a "directly related" test.

Determine whether each income-producing activity standing alone is tax-exempt.

Retain "substantially related" test; however, impose UBIT on specified activities (as listed in A-L below) whose nature and scope are inherently commercial, rather than charitable.

A. Apply UBIT to gift shop/bookstore income [with exceptions for (1) on-premise sales of low-cost mementos, (2) on-premise sales of an educational nature which relate to the organization visited, (3) in the case of a hospital, articles generally used by or for inpatients, (4) in the case of a university, articles in furtherance of educational programs, or low-cost items (dollar cap), and computer sales not in excess of one sale per student/faculty per year]. In addition, apply UBIT to income from all catalog and mail/phone order or other "off-premise" sales (with exception for de minimis sales, in relation to amount of "on-premise" sales).

B. Apply UBIT to all sales or rental income of medical equipment and devices (including hearing aids, portable x-ray units, oxygen tanks), laboratory testing, and pharmaceutical drugs and goods (with exceptions for (1) inpatients, continuous-care outpatients, or emergency treatment outpatients or (2) items not available in immediate geographic area.)

C. Apply UBIT to income from certain health, fitness, exercise and similar activities unless program is available to a reasonable cross-section of the general public such as by scholarship or fees based on community affordability.

D. Apply UBIT to travel and tour services (with exception for services provided by colleges/universities to students/faculty as part of a degree program curriculum, and de minimis sales to non-students/faculty.)

E. Apply UBIT to adjunct food sales (with exception for on-premise services and/or sales provided primarily for students, faculty, employees, members, or organization visitors).

F. Apply UBIT to income from certain veterinary services such as grooming, boarding, and elective surgery (with exceptions for spaying and neutering, measures to protect the public health, and measures recommended by a veterinarian for the health of the animal).

G. Apply UBIT to hotel facility income which is patronized by the public (with exception for facilities operated, but only to the extent necessary, in furtherance of the organization's exempt purpose). In addition, apply UBIT to certain sales of condominiums and time-sharing units.

H. Apply UBIT to routine testing income (with exceptions for Federal or State mandated activity, pre-surgical medical testing, and laboratory testing which is part of a student educational training program).

I. Apply UBIT to income from affinity credit card/catalog endorsements.

J. Apply UBIT to advertising income and allow deductions from UBIT only for direct advertising costs.

K. Apply UBIT to theme/amusement parks.

L. Apply UBIT to additional specified activities determined to be inherently commercial.

II. Convenience Exception:

Repeal "convenience" exception (income from activities carried on primarily for the convenience of a Section 501(c)(3) organization's members, students, patients, officers, or employees). Income from activities that are substantially related to the organization's exempt purpose would remain tax free, subject to the specific rules listed in Section I. above.

III. "Regularly Carried On" Test:

Repeal "regularly carried on" test. Income from an activity that is not a trade or business would remain tax-free.

IV. Tax Treatment of Royalty Income:

Apply UBIT to royalties measured by net or taxable income derived from the property; or royalties received by an organization for use of property if such organization, or closely related organization, either: (1) created such property, or (2) performed substantial services or incurred substantial costs with respect to the development or marketing of such property. Retain present law for certain non-working property interests, and exception for products that are part of the organization's exempt function.

V. Deduction from Taxable UBIT:

Increase $1,000 UBIT deduction for certain Section 501(c) organizations to $5,000 or $10,000, with phase-out beyond $50,000 income level. Limit the increased deduction to activities directly carried on by the exempt organization.

VI. Unrelated Debt-Financed Income:

Limit the current law UBIT exception for unrelated debt-financed property to only those pension funds, educational institutions and title holding companies that make at least a 20 percent equity investment of their interest in the property. Retain character of debt-financed income received from all pass-through entities.

VII. Subsidiaries and Joint Ventures:

Modify the definition of "control" in the case of exempt organizations having taxable subsidiaries. Define "control" as ownership directly, indirectly, or by attribution of at least 50 percent of stock, by vote or value (rather than 80 percent of combined voting stock, under present law).

Extend "control" rules where exempt organizations in the aggregate own more than 50 percent of the subsidiary's stock.

Provide that a controlled taxable subsidiary's income can be no less than its UBIT would have been if the income-producing activity had been carried on directly by the exempt parent organization.

Aggregate income and activities of controlled subsidiaries for purposes of determining if primary purpose of parent is a tax-exempt purpose.

VIII. Allocation Rules:

With respect to facilities used for exempt purposes as well as unrelated business purposes, allow a deduction against UBI for a proportionate share of the direct operating cost of the facility (e.g., maintenance, insurance, and utilities), but not allow a deduction for a share of the general overhead of the organization or for depreciation.

IX. Tax Information Reporting/Internal Revenue Service (IRS) Administration:

Expand Form 990-T reporting requirement to include more reporting on: (1) activities and income which the organization claims to be exempt or excluded from UBIT, and (2) revenue sources such as contributions, grants or other funding sources.

Provide more detailed reporting of revenue-producing activities and income on Form 990.

Consider "short form" reporting for small organizations, based on revenues.

Require affiliated group that includes an exempt organization to file a consolidated information return.

Recommend that IRS have an integrated examination program for exempt organizations and subsidiaries (taxable and exempt).

Recommend that IRS conduct the following studies and report on: (1) nonprofit exempt hospital reorganizations (examining the extent, purpose, effect of the use of subsidiaries); (2) exempt organizations that file Form 990s but do not file Form 990-T's (examining activities of a sample group to determine compliance with UBIT); (3) the feasibility of requiring State and Federal land-grant universities to file an information return; (4) the use, purpose and effect of joint ventures; and, (5) study, after five years, on effect of UBIT changes.

X. Miscellaneous:

Codify IRS position (upheld by some courts) that a social club (or other organization whose investment income is subject to UBIT) may not, in determining UBIT, reduce its net investment income by losses on sales to non-members.

Exempt from UBIT an organization's contingent rental income received through a prime tenant, where the prime tenant leases real estate from a tax-exempt organization, the prime tenant's net profits are based on fixed rents derived from subtenants, and the prime tenant does not provide services to subtenants except through an independent contractor.

Exempt from UBIT investment income earned from non-refundable loan commitment fees.

Modify rules applicable to organizations "testing for the public safety."

Consider modification of various piecemeal UBIT exclusions enacted since 1969.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any interested person or organization may submit comments on the discussion options. Persons submitting statements should submit at least six (6) copies by the close of business, Friday, April 15, 1988, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D. C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. **All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.**
2. **Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.**
3. **Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.**
4. **A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.**

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

CONTENTS

Page

Press release announcing request for written comments III

SUBMISSIONS RECEIVED

U.S. Department of the Treasury, O. Donaldson Chapoton, Assistant Secretary (Tax Policy) 1

Internal Revenue Service, Robert I. Brauer, Assistant Commissioner (Employee Plans and Exempt Organizations) 3

National Endowment for the Arts, Frank Hodsoll, Chairman 4

U.S. Small Business Administration, Frank S. Swain, Chief Counsel for Advocacy 7

A-Martin Hearing Aid Center, King of Prussia, Pennsylvania, Martin Slomine 16

Accurate Hearing Aid Centers, Inc., Columbus, Ohio, M.L. Zimmerman 17

ACI Auditory Centers:

- Otis A. Whitcomb, Milwaukee, Wisconsin 19
- Michael Thelen, Appleton, Wisconsin 20

Acousticon of Texarkana, Texas, A.L. Burns, Jr 21

Advanced Instruments, Concord, California, Patricia A. Williams 22

Agee, Jack and Jean, Pueblo, Colorado 23

Akron, Ohio, Symphony Orchestra, Robert R. Neu 24

Alabama Hospital Association, Tommy R. McDougal 25

Aldrich, Eastman & Waltch, The Boston Company, Copley Real Estate Advisors and Property Capital Associates 31

Allen Taylor Pharmacy and Hearing Aid Center, Elizabethton, Tennessee:

- Samuel G. McQueen 41
- Robert White 42

Amador Corporation, Taylors Falls, Minnesota, James Wm Johnson 43

American Analytical Laboratories, Tucson, Arizona, Athol L. Cline 48

American Animal Hospital Association, Milton L. Willen 49

American Arts Alliance, Anne G. Murphy 51

American Association for State and Local History, Larry E. Tise 61

American Association for the Advancement of Science, John D. Lane and Joseph B. Whitebread, Jr 63

American Association of Museums 65

American Association of Nurse Anesthetists, Mark R. Krzmarzick 71

American Association of Zoological Parks and Aquariums, Edward C. Schmitt and Kristin L. Vehrs 73

American Ballet Theatre, New York, New York, Charles Dillingham 75

American Board of Medical Specialties, Evanston, Illinois, Donald G. Langsley 76

American Bus Association, Norman R. Sherlock 77

American Camping Association, Frank M. Washburn 79

American Council of Independent Laboratories, Inc., Grover Williams 80

American Council on Education, Sheldon Elliot Steinbach 84

American Dental Association, William Allen 92

American Farm Bureau Federation, John C. Datt 94

American Foundation for the Blind, William F. Gallagher 98

American Geophysical Union, Athelstan F. Spilhaus, Jr 100

American Healthcare Institute, James L. Scott 103

American Hearing Aid Center, Richmond, Virginia, McRae B. Powers 105

American Heart Association 106

Page

- American Hospital Association, Jack W. Owen 111
- American Institute of Architects, Ted P. Pappas 123
- American Kidney Fund, Frank J. Soldovere 126
- American Lung Association, James A. Swomley 128
- American Medical Association 132
- American Numismatic Association, Robert J. Leuver 140
- American Society of Association Executives, R. William Taylor 142
- American Society of Travel Agents, Earlene L. Causey 144
- American Speech-Language-Hearing Association, Morgan Downey 146
- American Supply Association, Frank Finkel 151
- American Symphony Orchestra League, Catherine French 154
- American Veterinary Medical Association, Marcia D. Brody 156
- Ames, Iowa, Hearing Aid Center, Jerry D. Smith 158
- Arrowhead Hearing Aid Center, Duluth, Minnesota, Louise Olsen 159
- Art Center, Waco, Texas, Joseph L. Kagle, Jr 160
- Aspenwood Animal Hospital, Denver, Colorado, Duane T. Albrecht 161
- Association of American Medical Colleges 163
- Association of American Universities, Robert M. Rosenzweig and Milton Goldberg 170
- Association of American University Presses, Inc., E.H. Phillips 172
- Association of Art Museum Directors, Richard E. Oldenburg 176
- Association of Business Publishers, Robert A. Saltzstein 177
- Association of College Unions-International, Mark Bookman 179
- Association of Junior Leagues, Inc., Peggy M. Pschirrer 183
- Association of Physical Fitness Centers, Jimmy D. Johnson 184
- Association of the Bar of the City of New York, Committee on Non-Profit Organizations, Carolyn C. Clark 185
- Audio Hearing Aid Center, Boise, Idaho, Lawrence J. House 192
- Audiology Associates, Brunswick, Georgia, Richard D. Wright 193
- Audubon Naturalist Society of the Central Atlantic States, Inc., Elting Arnold 194
- Austin, Texas, Testing Engineers, Inc., Ted Parsons 197
- AVC Hearing Aid Center, Inc., Middleton, New York, Peter A. Meci 198
- Baltimore Museum of Art, Ann Allston Boyce 199
- Barden, Georgean A., St. Clair Shores, Michigan 201
- BCMW Community Services, Inc., Centralia, Illinois, Russell Rose, and Doris Clark 206
- Beltone Audio Services, Fallston, Maryland, Thomas A. Fisher 207
- Beltone Hearing Aid Centers:
  - James Boggess, Longmont, Colorado 208
  - John R. Czop, Longview, Texas 209
  - K. Johnny Elias and James A. Cochran, Memphis, Tennessee (identical letters) 210
  - Roland R. Erno, Ypsilanti, Michigan 211
  - Dennis Farnsworth, Lynchburg, Virginia 212
  - Ervin E. King, Billings, Montana 213
  - Anna F. Lewis, San Angelo, Texas 214
  - Karen S. Maas, Traverse City, Michigan 215
  - James Ogurek, Wausau, Wisconsin 216
  - Lawrence Ritter, Jackson, Michigan 217
  - K. Roger Smith, Ypsilanti, Michigan 218
  - Olin Stenbroten, Wisconsin Rapids, Wisconsin 221
  - Ellis J. Thomas III, Charleston, South Carolina 222
  - Hollis Underwood, Pasadena, Texas 223
  - Douglas R. Wagner, Bradenton, Florida 224
  - Carol Walczak, Jackson, Michigan 225
  - Curt Wallis, et al., Odessa, Texas 226
  - Claudia Williams, Ypsilanti, Michigan 227
- Bergwall Video Productions, Inc., Media, Pennsylvania, Bruce Bergwall 228
- Better Fabrics Testing Bureau, Inc., New York, New York, Gabriel A. Falla 229
- Better Hearing Aid Center, Greeley, Colorado, L.H. Vanderhoof 230
- Better Hearing Aid Service, Celina, Ohio, Donald J. Kratz, and James Frysinger (identical letters) 233
- Boca Raton, Florida, Museum of Art, Roger L. Selby 234
- Boston Museum of Fine Arts, Ross W. Farrar 235
- Bostonian Society, Joan C. Hull 236
- Boudouris, William B., Sylvania, Ohio 237
- Brandywine Conservancy, and Brandywine River Museum, Chadds Ford, Pennsylvania, James H. Duff 242

Page

Brenner Tours, Inc., Hopkins, Michigan, Pamela Brenner 244

Brorby, Thomas J., Austin, Texas 245

Brown County, Wisconsin, Thomas D. Cuene 251

Brown Hearing Aid Centers, Orange, Texas, Lee Brown, and Karlene Toohey (identical letters) 252

Brown-Potter Hearing Aid Center, Long Beach, California, Sallye B. Carpentier 253

Buffalo and Erie County, New York, Historical Society, William H. Siener 254

Business Coalition for Fair Competition, Joseph F. O'Neil 258

Butterworth Health Corporation, Grand Rapids, Michigan Dykema Gossett 270

California Academy of Sciences, San Francisco, California, Frank Talbot 278

California Committee for the Promotion of History, Cupertino, California, Carola G. Rupert 279

California Veterinary Medical Association, Richard Schumacher 280

Calvert Marine Museum, Solomons, Maryland, Ralph E. Eshelman 282

Canton, Ohio, Art Institute, Joseph R. Hertzi, et al 283

Canyon Hearing Aid Center, Nampa, Idaho, Dan McCuskey 285

Carey's Hearing Aid Service, Moscow, Idaho, Bob Shepard 286

Carroll Center for the Blind, Newton, Massachusetts, Rachel Ethier Rosenbaum 287

Catholic Health Association of the United States 288

Center for Non-Profit Corporations, Trenton, New Jersey, Judith Trachtenberg 294

Chicago Department of Human Services, Judith Walker 297

Chicago Historical Society, Ellsworth H. Brown 299

Children's Museum, Indianapolis, Indiana, Peter V. Sterling 301

Children's Television Workshop, David V.B. Britt 302

Christian Ministries Management Association, Diamond Bar, California 305

Civil Air Patrol, U.S. Air Force Auxiliary, Maxwell Air Force Base, Alabama, Brig. Gen. Carl S. Miller, USAF (Ret.) 308

Clarks Hearing Aid Service, Mattoon, Illinois, Gene Clark 310

Clarksville-Montgomery County, Tennessee, Historical Museum, Robert B. Patterson 311

Cleveland Museum of Natural History, J. Mary Taylor 313

College Board, New York, New York, Anthony J. Kearney 314

Columbus, Georgia, Museum, Anne Timpano 315

Columbus, Ohio, Assciation for the Performing Arts, Douglas F. Kridler 317

Computer Hearing Aid Distributors, Littleton, Colorado, Pat Davis 319

Corporation for Public Broadcasting, Donald E. Ledwig 322

Council on Non-Profit Organizations 324

Council on Research and Technology, Joseph A. Saloom 334

Coyote Point Museum, San Mateo, California, Linda Liebes 337

Cross Cultural Dance Resources, Flagstaff, Arizona, Joann W. Kealiinohomoku 338

Cumberland Science Museum, Nashville, Tennessee, William Bradshaw 339

Currier Gallery of Art, Manchester, New Hampshire, Kathy L. Jean 340

Da Camera Society, Houston, Texas, Jesse Ira Berger 341

Dallas Museum of Art, Jean Folwell 342

Darr & Associates, Inc., Chester R. Mischke, St. Joseph, Michigan, and David Wenger, South Bend, Indiana (identical letters) 343

Dash, Straus & Goodhue, Inc., Boxborough, Massachusetts, Glen Dash 344

Daughters of the American Revolution Museum, Washington, D.C., Catherine Tuggle 349

DCA Educational Products, Inc., Bedminister, Pennsylvania, Bennett V. Schultz 350

Denson Hearing Center, Howell, Michigan, Michael J. Denson 351

Denville, New Jersey, Hearing Aid Center, S. Markosian 352

Disabled American Veterans, Charles E. Joeckel, Jr 353

Edison Community College Gallery of Fine Art, Fort Myers, Florida, Jay Williams 355

Educational Commission for Foreign Medical Graduates, Philadelphia, Pennsylvania, Ray L. Casterline 356

Elderhostel, Inc., Boston, Massachusetts, Michael Zoob 357

Essex Institute, Salem, Massachusetts, Anne Farnam 365

ETL Testing Laboratories, Inc., Cortland, New York, Earl J. Gmoser 366

Farnsworth, William A., Library and Art Museum, Rockland, Maine, Christopher B. Crosman 367

Page

Findlay, Ohio, Hearing Aid Center, Timothy A. Boehr, and Jane M. Rosengarten 368
Foss Hearing Aid Center, Lewistown, Pennsylvania, Paul S. Foss 369
4-Seasons Vacations, Inc., Albert Lea, Minnesota, James Brecke 370
Frank Lloyd Wright Home and Studio Foundation, Oak Park, Illinois, Sandra K. Wilcoxon 371
Freeport, Maine, Historical Society, Marilyn Zoidis Gass 378
Friends of Independence National Historical Park, Philadelphia, Pennsylvania, Mrs. Edward A. Montgomery, Jr 379
Fullerton, California, Museum Center Association, Janet Buzan, and Joseph Felz 381
Goodman Theatre, Chicago Theatre Group, Inc., Roche Schulfer 382
Goodwill Industries, Inc 384
Great Lakes Theater Festival, Cleveland, Ohio, Mary Bill 389
Group Health Association of America, Inc., Leslie A. Rose 390
Hagey's Bus Service Inc., Franconia, Pennsylvania, Brian Hagey 392
Hansen Planetarium, Salt Lake City, Utah, Von Del Chamberlain 393
Harrison, Gerald James, Dallas, Texas 394
Health Industry Distributors Association 395
Hearing Aid Associates, Plainfield, New Jersey, Regina R. Persiano and Joseph J. Iacono (identical letters) 396
Hearing Aid Association of California, William F. Sandbach 397
Hearing Aid Center, Chehalis, Washington, Jan Divorne 398
Hearing Aid Center, Latham, New York, Daniel F. Martin, Sr 399
Hearing Aid Sales & Service, Inc., Dublin, Virginia, Janice Anderson 400
Hearing Aids Company, Duluth, Minnesota, E.W. Lundblad 401
Hearing Associates, Inc., Frank E. Gable and Evelyn L. Bele 402
Hearing Services of Tennessee, Inc., Nashville, Tennessee, Sheri W. Kirshner 403
Higgins Armory Museum, Worcester, Massachusetts, John F. Stevens 405
Hillman Hearing Aid Center, Inc., Middletown, New York, William R. Hillman 406
Hinman, William, F. Whitney Jones Consulting Services, Inc., Fund-Raising Counsel, Winston-Salem, North Carolina 407
Historic Bethlehem, Inc., Bethlehem, Pennsylvania, Ruthella Sherman 409
Historic Landmarks Foundation of Indiana, Indianapolis, Indiana, J. Reid Williamson, Jr 410
Historic Southwest Ohio, Inc., Cincinnati, Ohio, Frank G. Davis 411
Historic St. Augustine, Florida, Preservation Board, William J. Daniell 412
Holland Hearing Aid Center, Lubbock, Texas, George Holland, Jr 413
Hopkins, Bruce R., Washington, D.C 414
House of Hearing Aids, St. Louis, Missouri, Bernard Barnard 419
    (Identical letters also received from:)
        Larry Brethower, Springfield, Missouri
        Annette Cook, St. Joseph, Missouri
        James W. Gallaher, Hopmeier Hearing Aids, St. Louis, Missouri
        Mark Goffinet, M&M Hearing Aid Company, Columbia, Missouri
        W.F.S. Hopmeier, Hopmeier Hearing Aids, St. Louis, Missouri
        Jim Jones, Jefferson City, Missouri
        Homer Miller, Joplin, Missouri
        Charles Murdock, Springfield, Missouri
        James Shandy, Maico Hearing Aid Center, Cape Girardeau, Missouri
        Gregory Sommer, Beltone Hearing Aids Service, St. Louis, Missouri
        N.S. Vickery, Farmington, Missouri
        Ed Wolfe, Richmond, Missouri
House of Hearing, Inc., Lancaster, Ohio, James A. Nevins 425
Houston Grand Opera, Dolores Johnson 429
Hullet, Edward, et al, Wichita, Kansas 430
Humane Society of the United States, and the Michigan Humane Society, William M. Brodhead 432
Illinois Community Action Association, Springfield, Illinois, Donald J. Tebbe 434
Independent Petroleum Association of America 437
Independent Sector, Brian O'Connell 439
International Communications Industries Association, Kenton Pattie 448
International Racquet Sports Association, John McCarthy 454
International Taxicabs Association, Gene R. Stalians 457
Iroquois County Historical Society, Watseka, Illinois, Alan L. Benjamin 459
Istre, Clifton, O., Jr., Lafayette, Louisiana 460

Page
J.P. Morgan Investment Management, Inc., John E. Chapoton, L. Price Manford, and Christine L. Vaughn 461
Jamieson Hearing Aid, Southgate, Michigan, Philip G. Jamieson 464
Joslyn Art Museum, Omaha, Nebraska, Henry Flood Robert, Jr 465
Junior League of Tyler, Texas, Inc., Shane Voight and Marilyn Hardy 468
Kaiser Foundation Health Plan, Inc 469
Katz Hearing Aid Center, Tucson, Arizona, K. Ray Katz 471
Kitsap County Historical Society, Silverdale, Washington, Suzanne T. Anest 472
Krasl Art Center, St. Joseph, Michigan, Darwin R. Davis 473
Lackawanna Historical Society, Scranton, Pennsylvania, Dorothy Alan Silva 474
Laguna Gloria Art Museum, Austin, Texas:
  Laurence Miller 475
  David West 476
Lambda Research Incorporated, Cincinnati, Ohio, Paul S. Prevey 478
Lancaster, Pennsylvania, Laboratories, Earl H. Hess 479
Laucks Testing Laboratories, Inc., Seattle, Washington, James M. Owens 481
Leva, Hawes, Mason, Martin & Bebchick, Washington, D.C., Arthur K. Mason 482
Lisbeth, Inc., Eden, North Carolina, Joseph Chandler 485
Literacy Volunteers of America, Inc., Arthur Bongiovanni 486
Los Angeles Theatre Center, Bill Bushnell 487
Loupot, Floyd, Pasadena, California 489
Luray, Virginia, Travel Bureau, Karl W. Helfit 490
MacNider, Charles H., Museum, Mason City, Iowa, Richard E. Leet 492
Madison, Wisconsin, Art Center, Michael J. Paggie 493
Maico Hearing Aid Service of Springfield, Inc., Springfield, Missouri, Albert L. Mattingly 494
Maine Maritime Museum, Bath, Maine, John S. Carter 495
Marshall, Texas, Memorial Hospital-H.C.H.A. Inc., Sam L. Oney 497
Mary MacIntosh Services, Inc., Allentown, Pennsylvania, Arnold R. Kuthy 498
Massachusetts Materials Research, Inc., West Boylston, Massachusetts, David Krashes 500
Master Plan Hearing Aids, Florissant, Missouri, Ken Jones 501
MasterCard International, Inc., and VISA U.S.A. Inc., Tony M. Edwards 502
McQueen's Hearing Aid Center, Greeneville, Tennessee, Ann K. Lacy 507
MEI-Charlton, Inc., Portland, Oregon, Don Valley 508
Memorial Care Systems, Houston, Texas, Jim Gasper 509
Meston Vacation World, El Paso, Texas, Harvey Meston 511
Methodist Hospital System, Houston, Texas, Larry L. Mathis 512
Metropolitan Museum of Art, New York, New York, William H. Luers 521
Michigan Veterinary Medical Association, East Lansing, Michigan, Peter A. Prescott 526
Micro Analytical Laboratories, Inc., Gainesville, Florida, Robert A. Longo 528
Mid-Atlantic Association of Museums, Lynne F. Poirier 529
Middle Tennessee Hearing Aid Center, Inc., Columbia, Tennessee, Daniel W. West 530
Midwestern Universities Alliance, Newton O. Cattell 531
Minneapolis Institute of Arts, Marvin Borman 534
Minnesota Museum of Art, St. Paul, Minnesota, M.J. Czarniecki III 535
MIT Museum, Cambridge, Massachusetts, Warren Seamans 537
Moody Bible Institute of Chicago, William J. Lehrfeld 539
Moran & Woodhouse Galleries, Museum Section, East Hampton, New York, Judith B. Sneddon 549
Museum Association of the American Frontier, Chadron, Nebraska, Charles E. Hanson, Jr 550
Museum of New Mexico Foundation, Santa Fe, New Mexico, Sandra A. Edelman 551
Museums, The, at Stoney Brook, Long Island, New York, Susan Stitt 552
Muskegon, Michigan, Museum of Art, Al Kochka 553
National Assembly of National Voluntary Health and Social Welfare Organizations and the Grants and Contracts Project 554
National Association of College and University Business Officers, Mary Jane Calais 564
National Association of College Stores 567
National Association of Exposition Managers, Inc., Donald J. Walter 573
National Association of Independent Colleges and Universities, Sandra H. McMullan 576
National Association of Independent Schools, and the Independent Education Fund 578

Page

National Association of Public Television Stations, Martha Malkin Zornow 579
National Association of Real Estate Investment Trusts, Charles R. Gardner 584
National Association of Realtors 590
National Association of Retail Druggists, John M. Rector 595
National Automobile Dealers Association, H. Thomas Greene 606
National Club Association, Leonard J. Henzke, Jr., and William J. Lehrfeld 610
National Cosmetology Association, Inc., Lauren R. Howard 614
National Easter Seal Society 616
National Electrical Contractors Association, Inc 622
National Federation of Independent Business, John J. Motley III 626
National Geographic Society, Gilbert M. Grosvenor 629
National Guard Association of the United States, Lt. Gen. La Vern E. Weber, NGUS (Ret.) 632
National Hearing Aid Society, James P. Lovell 634
National Laboratories, Inc., Evansville, Indiana, G.C. Shultz 638
National Mining Hall of Fame and Museum, Inc., Leadville, Colorado, Robert T. Reeder 640
National Office Products Association, Donald P. Haspel 642
National Public Radio, Douglas J. Bennet 644
National Roofing Contractors Association, William A. Good 646
National Rural Electric Cooperative Association, Wallace F. Tillman 649
National Telephone Cooperative Association 651
National Tour Association 654
National Wildlife Federation, Joel T. Thomas 657
Nebraska Testing Corporation, Omaha, Nebraska, Daniel E. McCarthy 664
Neville Public Museum, Green Bay, Wisconsin:
    Ann L. Koski 665
    Loretta Murphy, Sales Gallery 666
    Elizabeth J. Pfeifer, Governing Board 667
New England Aquarium, Boston, Massachusetts, John H. Prescott 668
New Jersey Guild of Hearing Aid Dispensers, Trenton, New Jersey, George T. Dougherty 669
New Life Hearing Instrument Centers, Baltimore, Maryland, Don Brugman 672
Noah Webster Foundation and Historical Society of West Hartford, Connecticut, Inc., Sally Williams, Sally Whipple, and Ruth Wessels 673
Nolan, John W., Phillip L. Mann, and Kevin L. Kenworthy, Washington, D.C. 678
Nonprofit Coordinating Committee of New York, Peter Swords 688
North Carolina Museum of Art Foundation, Inc., Releigh, North Carolina, Samuel M. Stone 690
Novak Hearing Center, Lakeland, Florida, Charles J. Novak 691
Odessa, Texas, Hearing Aid Center, Mike and Susan Wallis 694
Ohio Citizens' Council, Columbus, Ohio, Russell C. Shaw 695
Ohio State University, Weldon E. Ihrig 696
Old Sturbridge Village, Massachusetts, Crawford Lincoln 699
Ontario Hearing Instruments Corp., Telex Hearing Aid Center, Rochester, New York, Howard S. Meltzer 700
Opelousas, Louisiana, General Hospital, Terry L. Stofferson 701
OPERA America, Martin I. Kagan 702
OperaDelaware, Greenville, Delaware, Jane Langley 703
Pacific Linen Service, Oxnard, California, Joseph M. O'Grady 706
Peabody Museum, Salem, Massachusetts, Peter Fetchko, and Anne Wood Lipner 707
Penniman & Browne, Inc., Baltimore, Maryland, Herbert E. Wilgis, Jr 708
Pennsylvania Veterinary Medical Association, Kenton S. Stokes 709
Philadelphia Museum of Art, Cheryl McClenney-Brooker 710
Pierpont Racquet Club, Ventura, California, Spencer Garrett 712
Pikes Peak Hearing Aid Center, Colorado Springs, Colorado, Frank A. Kroeze 714
Poets & Writers, New York, New York, Elliot Figman 715
Portland, Maine, Symphony Orchestra, Jane E. Hunter 716
Princeton University Art Museum, Charles K. Steiner 718
Pro Football Hall of Fame, Canton, Ohio, F. Stuart Wilkins, William Belden, Clayton G. Horn, and John Mulback (identical letters) 719
Professional Hearing Aid Service, Brooklyn, New York, Ernest Zelnich 720
Purdue University, West Lafayette, Indiana, Steven C. Beering 721
Putnam Museum, Davenport, Iowa, Michael J. Smith 723
Quiet Valley Living Historical Farm, Stroudsburg, Pennsylvania, Sue W. Oiler 725
Raba-Kistner Consultants, Inc., San Antonio, Texas, Carl F. Raba, Jr 728

Page
Rocky Mountain Hearing Aid Company of Montana, Inc., Kallispell, Montana, Byron Randall 729
RREEF Funds, Tony M. Edwards 730
Saad, James, L. and James L., Jr., Cape May Court House, New Jersey 732
Sacred Heart League, Walls, Mississippi, Roger Courts 733
San Francisco Museum of Modern American Art, John R. Lane 735
San Francisco Symphony, G. Michael Gehret 737
Sandusky, Ohio, Audiology, Frank (Pete) Fox 739
Screen Printing Association International, John M. Crawford 740
Shaker Lakes Regional Nature Center, Cleveland, Ohio, Richard A. Horton 742
Shriners Hospital for Crippled Children, Tampa, Florida, William J. Lehrfeld . 743
Shuttle Service, Inc., Hattiesburg, Mississippi, Tom J. Curtis 751
Sierra Club, J. Michael McCloskey 752
Simpich, Frederick, Davis & Simpich, Washington, D.C 757
Slater Mill Historic Site, Pawtucket, Rhode Island, Mark McDonough 758
Sloan, Alfred P., Museum, Flint, Michigan, Phillip C. Kwiatkowski 759
Small Business Legislative Council, John S. Satagaj 760
Smithsonian Institution, Washington, D.C 764
Society for the Performing Arts, Houston, Texas, Hoyt T. (Toby) Mattox 769
Society of the National Shrine of the Bill of Rights at St. Paul's Church, Eastchester, Inc., Mount Vernon, New York, Connie M. Cullen 770
Sonoma County Museum, Santa Rosa, California, John Z. Lofgren 771
Southern Forest Products Association, New Orleans, Louisiana, Karl W. Lindberg 774
Sports Connection, Los Angeles, California, Mike Talla 775
Springfield, Ohio, Art Center, Christine A. Myers 777
St. Edwards University, Austin, Texas, Patricia A. Hayes 778
St. Elizabeth's Hospital of Boston, William J. Skerry 780
St. Lawrence County Historical Association, Canton, New York, Garrett Cook. 785
St. Luke's Episcopal Hospital, Houston, Texas, John A. Burdine 786
Stallons, Ray and Ken, Ray Stallons and Associates, Sioux City, Iowa 793
Starlight Theatre Association of Kansas City, Inc., Robert M. Rohlf 794
Staten Island, New York, Institute of Arts and Sciences:
    Susan Malus 796
    Patricia Gordon Michael 797
Strong, Margaret Woodbury, Museum, Rochester, New York, G. Rollie Adams 799
Sun Inn Preservation Association, Bethlehem, Pennsylvania, Mary Anne Hager 800
Swap Northwest, Seattle, Washington, Marlene V. Moore 801
Tampa, Florida, Hearing Aid Center Inc., Gerald A. Amato 802
Teachers & Writers Collaborative, New York, New York, Nancy Larson Shapiro 803
Tempe, Arizona, Historical Museum, Amy A. Douglass 804
Texas Hearing Aid Association, Fort Worth, Texas:
    Curt Wallis 806
    Jim Wilson 807
Textile Rental Services Association of America, John J. Contney 810
Theatre Communications Group, Inc., New York, New York 814
Thornton W. Burgess Society, Sandwich, Massachusetts, Robert T. McMaster .. 822
Timco, Engineering, Inc., Miami, Florida, Sid Sanders 824
Torch Energy Advisors, Inc., Houston, Texas 825
Tri City Hearing Aid Battery Service, Madison, Illinois, A.W. Davis 827
Tri-State Hearing Aid and Audiology Center, Inc., Frederick, Maryland, Betty L. Jensen 828
U.S. Border Patrol Museum, El Paso, Texas, Terrie Cornell 829
U.S. Chamber of Commerce, Albert D. Bourland 830
U.S. Health, Inc., Towson, Maryland, Allen D. Greif 832
Ukrainian Museum, New York, New York, Maria Shust 833
Underwriters Laboratories Inc., Northbrook, Illinois, Jack Bono 834
United Hospital Fund of New York, Bruce C. Vladeck 843
United Ostomy Association, Irvine, California, Linda K. King 846
United States Catholic Conference, Mark E. Chopko and Dierdre Halloran 848
United States League of Savings Institutions, Coley O'Brien 852
United States Testing Company, Inc., Hoboken, New Jersey, Allen F. Maxfield 856
United Way of America 858
United Way of Illinois, Chicago, Illinois, Rebecca Owens 871
University of California, Paul Sweet 878

Page
University of Nebraska, Lincoln School of Music, Kerry S. Grant 882
University of Rochester, New York, Memorial Art Gallery, Grant Holcomb 884
University of Tennessee, Knoxville, Tennessee, Joseph E. Johnson 886
University of Texas System, Austin, Texas 890
Vanderbilt University, Nashville, Tennessee, Jeff Carr 899
Victoria Society of Maine, Portland, Maine, Harriet Lutes and Glenn Uminowicz (identical letters) 904
Viterbo College, La Crosse, Wisconsin, Thomas Rinert 905
Voluntary Hospitals of America, Inc., Daniel P. Bourque 906
Volunteer Trustees of Not-For-Profit Hospitals, Washington, D.C 907
Washington Hearing Aid Center, Seattle, Washington, Robin L. Holm 911
Waukesha, Wisconsin, County Museum, Jean Penn Loerke 912
WB&E-O.H. Hirt, Philadelphia, Pennsylvania, Sydney G. Willson 913
Webster, Chamberlain & Bean, Washington, D.C., Frank M. Northam 914
Wenham, Massachusetts, Historical Association and Museum, Inc., Eleanor E. Thompson 919
Western States Arts Federation, Santa Fe, New Mexico, Terry R. Melton 920
Whatcom Museum of History & Art, Bellingham, Washington, George E. Thomas 922
Williams College Museum of Art, Williamstown, Massachusetts, W. Rod Faulds 923
Wisconsin Alliance of Hearing Professionals, Madison, Wisconsin:
  Douglas Q. Johnson 924
  James A. Bohren, Sheboygan, Wisconsin 927
Woodard Hearing Aid Centers, Des Moines, Iowa, Paul E. Woodard 944
Woodson-Tenent Laboratories, Inc., Memphis, Tennessee, Ned McCarthy 947
Worcester, Massachusetts, Art Museum, Patricia A. Doran 950
Yale University Art Galley, New Haven, Connecticut, Howard el-Yasin 951
Yale University, Peabody Museum of Natural History, New Haven, Connecticut, James Krieger 952
YMCA of the USA, Robert A. Boisture 953
Young's Hearing Aid Service, Columbia, South Carolina:
  G. Charles Young 955
  John H. Young, Jr 956
YWCA of Chemung County, New York, George F. Murphy 957
YWCA of Los Angeles, Sandra Jones Anderson 958
YWCA of the U.S.A., National Board, Gwendolyn Calvert Baker 959

DEPARTMENT OF THE TREASURY
WASHINGTON
ASSISTANT SECRETARY

April 15, 1988

Dear Mr. Chairman:

This letter is in response to your request of April 6, 1988 that the Treasury Department comment on the Oversight Subcommittee's list of "discussion options" regarding possible revisions to the unrelated business income tax ("UBIT"). The March 31, 1988 press release setting forth the discussion options stated that you expect to schedule a hearing on the options in late April. Although our testimony before your committee will analyze the options in greater detail, I am pleased to have this opportunity to describe our overall reaction to the options and to identify those areas where we have some questions.

Both you and the entire Oversight Subcommittee are to be commended for undertaking a fresh look at this important area of the law, one which has not been reviewed thoroughly by Congress since 1969. The five days of hearings held last June, together with the many constructive comments submitted by interested parties, have shed a great deal of light on the structure and administration of the UBIT.

The discussion options, taken as a whole, represent a comprehensive effort to address many of the difficult issues that arise under the UBIT. You have not presented the options as a legislative package and we are not in a position to either endorse or oppose the entire options paper. Nonetheless, many of the options are consistent with my testimony before your committee on June 22, 1987 (the "June testimony") and we are generally supportive of the approach taken in the options paper.

The discussion options include a number of proposals discussed in my June testimony. In addition, there are a number of proposals not considered in my testimony. I will discuss each in turn.

I. Options Discussed in the June Testimony

The discussion options that were addressed in my June testimony include the following:

- Repeal the convenience exception.
- Increase the $1,000 UBIT deduction.
- Tax royalties measured by net or taxable income.
- Modify the definition of a controlled subsidiary.
- Aggregate controlled subsidiaries when determining whether the parent is tax-exempt.
- Expand reporting requirements.

Our position that these areas warrant Congressional attention is unchanged. We believe the options regarding improved data collection and certain mandated studies are especially important to the long-term effort to analyze the UBIT and tax exemption in general. Other discussion options address issues that I discussed in my June testimony, but they propose alternate solutions to those I suggested. These include, for example, allocation rules and the taxation of royalty income. We believe the discussion options in these two areas are particularly significant and we intend to comment on them in detail in our testimony.

II. Other Proposals

The discussion options also include a number of possible changes to current law that were not addressed in my June testimony. Many of these options, such as applying the UBIT to bookstores or to routine testing, would serve generally to codify, with minor changes, certain aspects of the case law and administrative practice that have developed in this area.

Codifying such rules would serve two functions. First, it would increase awareness on the part of exempt organizations as to applicable law. Second, it would aid administration and enforcement of the law by setting forth relatively bright lines between exempt and taxable activities in each of the specified areas. Thus, for example, a college bookstore would know that all souvenir items below a certain dollar level would be exempt from tax and that all other non-educational sales would generally be subject to tax. Although some of the listed areas would still involve difficult line-drawing, the rules would in many instances settle disputes between exempt organizations and the IRS as to whether the sale of a particular good or service is in fact "substantially related" and would thus reduce many administrative problems.

Other options represent significant changes to current law. Such is the case with the first two options -- adopting a "directly related" standard or testing every activity standing alone for tax exempt purpose. Either option would throw existing law and administrative practice into doubt for all exempt organization activities, including those that Congress presumably does not wish to affect. The difference between "substantially related" and "directly related," for example, is not at all clear and thus this option would require a re-examination of all activities currently considered to be substantially related. Similarly, despite the conceptual appeal of testing each activity separately for exempt purpose, we are concerned that the effect of such a rule could be very far-reaching.

Another option that raises especially significant tax policy questions is the taxation of activities deemed to be "inherently commercial," whether that determination is made by Congress or by the IRS. Taxing all activities that are inherently commercial would be a significant departure from current law. Many tax-exempt organizations -- particularly hospitals and universities -- are "commercial" in that the great majority of their income is derived from the sale of services to the general public. Thus, introducing inherently commercial as a statutory category could create widespread confusion as to who is affected by the rule. We would urge instead that Congress identify the particular activities that it considers not to merit tax exemption, as it did for the sale of commercial insurance products in the Tax Reform Act of 1986.

With respect to many of the remaining options not discussed in my June testimony, there exists controversy between exempt organizations and the IRS regarding the correct interpretation of present law, and thus legislative clarification would be particularly appropriate. For example, the application of the UBIT to sales or rental of medical equipment or the rules regarding social clubs are both subject to differing interpretations of present law. We will comment further on such options in our testimony.

III. Conclusion

As I indicated earlier, whether Treasury would support or oppose a legislative package making changes to the UBIT would depend on a number of factors, including the mix of options selected, the precise formulation of each option, and the revenue implications of the package. We are actively studying policy, revenue and administrative implications of all of the options and we will be able to elaborate upon our responses in testimony before your committee later this month.

Mr. Chairman, I thank you for this opportunity to comment on the UBIT discussion options. We share your desire to examine and improve this area of the law and we appreciate the hard work that went into preparing the discussion options.

Sincerely,

O. Donaldson Chapoton
Assistant Secretary
(Tax Policy)

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

ASSISTANT COMMISSIONER
(EMPLOYEE PLANS AND
EXEMPT ORGANIZATIONS)

APR 15 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
Washington, DC 20515

Dear Chairman Pickle:

On behalf of Commissioner Gibbs, this letter responds to your request of April 6, 1988, for the Internal Revenue Service's comments on the Oversight Subcommittee's preliminary discussion options regarding the unrelated business income tax.

Last June, when the Commissioner and I testified before your Subcommittee, we noted a number of areas of interpretative and enforcement difficulties in administering the unrelated business income tax. These included problems relating to the "substantially related" test, the "regularly carried on" requirement, and the allocation of income and expenses between exempt and nonexempt activities. Having reviewed the preliminary discussion options, we believe that, all in all, they are responsive to the tax administration concerns described in our June testimony. We also believe the discussion options provide an excellent framework for legislatively resolving major problems in this area.

We wish to bring to your attention the fact that your Subcommittee's work may be having a salutary effect on the administration of the unrelated business income tax, as evidenced by recent dramatic increases in the revenues produced by this tax. We therefore think it is most important that the Subcommittee continue its work in this area for the purpose of enacting clearer and more coherent rules for the determination of liability for tax on unrelated business income.

As you know, we are working closely with the Treasury Department on the specific discussion options. We look forward to testifying before your Subcommittee in the near future. In the meantime, be assured we will continue to provide whatever assistance you require in addressing this important matter.

Sincerely,

Robert I. Brauer

Robert I. Brauer

NATIONAL ENDOWMENT FOR THE ARTS
FRANK HODSOLL, CHAIRMAN

April 15, 1988

Chairman J.J. Pickle
Oversight Subcommittee
Committee on Ways & Means
1105 Longworth House Office Building
Washington, D.C.20515

Dear Mr. Chairman:

I was delighted that the Austin arts community invited you to speak at the Texas Association of Sympony Orchestras meeting during my visit with them last week. Since the issue of the proposed changes to the unrelated business income tax was on their minds, I appreciate your asking me to provide views on behalf of the National Endowment for the Arts on the discussion options you released in your press release of March 31, 1988. I should note at the outset that our comments reflect only the views of the Endowment.

The National Endowment for the Arts was established (P.L. 89-209) in 1965 as the Federal agency charged to encourage and support "national progress in the arts". The Endowment provides grants and leadership in support of artistic excellence and access to, and appreciation of, the arts. Endowment grants to institutions qualifying as tax exempt under Section 501(c)(3) of the Tax Code (83 percent of the total value of all grants in FY 86) must generally be matched with non-Federal funds at least one to one, and one of the goals of the Endowment is to stimulate increased non-Federal support to arts organizations so as to enhance their financial stability.

Based on 23 years of working with the nation's non-profit arts community, we wish to comment on the potential effects on that community of some of the options before the Committee for reforming the unrelated business income tax law (UBIT). We hope that our perspective will be useful to Members of the Committee as they study the issues surrounding UBIT.

As our enabling legislation notes, "the encouragement and support of national progress and scholarship in the humanities and the arts, while primarily a matter for private and local intiative, is also an appropriate matter of concern to the Federal

Government". While this legislative provision provides a part of the justification for Endowment funding, it also recognizes the primacy of private and local support for the arts. And, even though the Endowment has grown from a budget of $2.9 million in 1966 to $167.7 million in 1988, basic support for the non profit arts continues to come from the private sector -- perhaps on the order of $12-15 billion in 1986. This support, which includes in many cases equal proportions of earned and contributed income, is, and has always been, encouraged by our tax laws. Since virtually all of cultural heritage and most contemporary artistic expression are presented by, or result from, the non profit arts sector, that sector's encouragement is in the public interest.

There is no question that non profit arts institutions, like other non profit institutions, should pay tax on unrelated business income. The amendments to the Internal Revenue Code in 1950 correctly recognized this. No tax exempt organization should through its tax exemption obtain an unfair competitive edge over tax paying businesses carrying on similar commercial activities. We at the Endowment understand the concern of parts of the "for profit" community in this respect.

We also agree that your Committee is correct in examining the issues involved with unrelated business income, with a view to investigating and developing remedies for any abuses. On the other hand, we would urge the Committee to proceed cautiously and assure adequate documentation of unfair competition, as well as documentation of the impact on non profit activities, before making specific recommendations to Chairman Rostenkowski.

We believe such information, particularly as it relates to the non profit arts sector, is not yet available. Last year I talked with committee staff about the need for more information and offered the Endowment's assistance in developing it. It was our understanding that this was welcomed by committee staff as a basis for proceeding.

We therefore suggest that, before proceeding with specific recommendations along the lines of the discussion options set out in your March 31 press release, a systematic effort (with deadlines) be undertaken to develop a thorough analysis of both the problem and the measures for its resolution. The Endowment would be prepared to cooperate in any way the Committee deemed useful in assisting with this effort.

While we cannot presently document this it is our impression that current law and regulations generally protect against abuses, at least in the non profit arts sector. The American Arts Alliance's testimony in June 1987 noted that most respondents to their survey had never been audited by the Internal Revenue Service regarding unrelated business income. Of the 35 institutions that received such audits, 25 were found by the IRS to be in compliance with the law and 9 were awaiting a final ruling. The survey indicated that only one institution responded that the final audit was unfavorable.

In sum, Mr. Chairman, we agree with the Committee's wish to investigate the issues involved in unrelated business income tax, but we believe this investigation should begin with development of data and a thorough analysis of both the problem and potential impacts of remedies. The remedy should not create a worse problem than whatever the current problem may be.

We believe it is premature at this point to proceed with specific legislative provisions, although the subcommittee's discussion options should be a beginning point for testing impacts in the various non profit sectors after a more detailed identification of the problem of unfair competition, particularly as it relates to the non profit arts sector.

Finally, Mr. Chairman, because you requested comments from us only seven days ago, the Endowment is not yet in a position to comment specifically on each of the discussion options. We would like to do that shortly. However, we would note that our comments must at best be preliminary since there is no real data on the issues involved.

I am very grateful for the opportunity to provide these comments to your Subcommittee. I would like to take you up on your offer to talk about this personally. Perhaps this would be possible in the next few weeks after you have had a chance to digest these and other comments and after we have had a chance to develop more specific views on the discussion options themselves.

Best regards.

Sincerely,

Frank Hodsoll

Frank Hodsoll
Chairman

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

April 15, 1988

Robert J. Leonard
Chief Counsel, Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I commend the Subcommittee for considering specific options to reform the unrelated business income tax (UBIT) and improve data collection on the extent of tax-exempt commercial activity. I also support addressing the issues that have arisen with regard to the royalty exclusion, the allocation rules and the use of taxable subsidiaries, and look forward to more refined recommendations on these issues as the Subcommittee continues its work with the Department of the Treasury. The options serve as an excellent starting point for reform and will go far toward resolving the issue of unfair competition between tax-exempt and taxable organizations.

This letter reaffirms my support for these essential changes and suggests several modifications to options which reflect priorities for the small business community. I believe that the changes proposed herein would further strengthen the effectiveness of UBIT and minimize the circumstances under which unfair competition can occur.

With respect to the Subcommittee's options, I recommend that the Subcommittee: (1) tighten the "substantially related" test in order to better confine the condition of nontaxability of an activity to an organization's primary exempt purpose; (2) if the "inherently commercial" test is adopted, eliminate or narrow safe harbors for specific activities enumerated in A. through L.; (3) repeal the "convenience" exemption without allowing for exceptions; and (4) provide more detailed recommendations for improving data collection/analyses, notably for establishing a cap on commercial income and estimating tax-exempt subsidies.

Outside of the discussion options, I recommend that the Subcommittee: (1) create an IRS administrative channel for receiving and investigating complaints relating to unfair competition; (2) eliminate the exemption in Internal Revenue Code (IRC) § 501(c)(3) for entities organized solely to test for the public safety; (3) narrow the exception for college, university and hospital research; and, (4) if an "inherently commercial" test is adopted, limit the exception for volunteer labor.

I. The "substantially related" test should be tightened to require that the nontaxibility of an activity be conditioned upon the activity itself fulfilling the exempt purpose of the organization.

The "substantially related" test, which seeks to distinguish between commercial activities which are properly taxable or nontaxable, has failed to fulfill its essential function of protecting small businesses from unfair competition. The test has proven unworkable in practice, yielding hair-splitting or irreconcilable distinctions. Examples of cases and IRS rulings cited in my June 22, 1987 testimony and the personal accounts of small business witnesses before the Subcommittee vividly illustrate the disparate activities conductible within the test's broad framework. Tax-exempt organizations have clearly relied on the ambiguous nature of the substantially related test to include many commercial activities under the umbrella of their tax-exempt status. Moreover, commercial activities that clearly satisfy the "substantially related" test have caused unfair competition.

The inability of the current "substantially related" test to perform its protective function is evidenced by data which show that few tax-exempt organizations reported unrelated business income during a time of their increased reliance on commercial income.[1] In 1985, the total tax revenue raised from the UBIT totaled less than $40 million. For the same year, the combined gross receipts of exempt organizations exceeded $250 billion.[2] In addition, a 1987 random audit of Form 990-T returns revealed that one-third had deficiencies in UBIT reporting of between 30 and 50 percent.[3] For Fiscal Year 1985, basic UBIT revenues reported in 24,000 returns were $30 million for 1986, 32,000 returns reported $55 million, and for 1987, 33,000 returns reported $120 million.[4] The present "substantially-related" test is clearly unpredictable and subjective.

The Subcommittee should better define the "substantially related" test, for example, by exempting from taxation only those income-producing activities which are so fundamental to the organization's exempt purpose as to be a mere extension of it, and are capable of standing alone as tax-exempt activities. This does not reject the "substantially related" test; rather it would clarify the borders of permissible activities for managers of tax-exempt organizations, enforcement officials and the courts, consistent with the exempt organization's primary mission. As a result, both compliance with the UBIT and its administration would improve.

II. Proposed safe harbors for specific activities exempt from UBIT should be narrowed and focused.

I believe it is essential that the Subcommittee recommend a clear and significant narrowing of the "substantially related" test. The debate on commercial activities of tax-exempts has been, in many cases, stimulated by activities which could never have been predicted in 1950 or 1969. The best legislative approach, therefore, will be a strong general standard applicable to all situations in which potential nonprofit competition issues may occur. Listing a potential series of UBIT safe harbors is not a substitute for strengthening the general test.

---

[1] "Tax Policy: Competition Between Taxable Businesses and Tax-Exempt Organizations," Briefing Report to the Joint Committee on Taxation, U.S. Congress, by the General Accounting Office, February, 1987, GAO/GRD-87-40-BR.

[2] "Data Collection Plans for the Nonprofit Sector: What Do We Need to Know?," Jerald Schiff & Janette Huffman, prepared for the Independent Sector Spring Research Forum, March 17 and 18, 1988, San Francisco, California, p. 2.

[3] Ibid.

[4] Unpublished statistics from the IRS.

We do have specific comments on several of the Subcommittee options. In general, our comments occur where the underlying rationale for continued exemption appears unclear or where the Subcommittee suggests broad exceptions not dissimilar to the current laws which contain ambiguities or standards that have generated the complaints to date.

A. UBIT would be applied to income from the sale of gift shop/bookstore items except: (1) on-premise sales of low-cost mementos; (2) on-premise sales of of an educational nature which relate to the organization visited; (3) in the case of a hospital, articles generally used by or for inpatients; and, (4) in the case of a university, articles in furtherance of educational programs, or low-cost items, and computer sales not in excess of one sale per student/faculty per year. In addition, UBIT would apply to all catalog and mail/phone orders or other "off-premise" sales (with exception for de minimus sales, in relation to the amount of "on-premise" sales). We recommend that except for low cost mementos, the exceptions be eliminated or significantly clarified. The exceptions to the general rule that the UBIT applies to gift shop/bookstore income are overly broad and would guarantee the continuation of many instances of unfair competition.

Excepting on-premise sales of an "educational" nature which "relate" to the organization visited perpetuates ambiguities existing under current law. Whether an item is "educational" and "relates" to the institution visited are subjective determinations which provide little guidance to tax-exempt managers or enforcement officials. Will zoos be permitted to sell stuffed pandas without paying taxes on them? Are the sales of such articles deserving of tax-exemption even though such goods can be readily supplied by the for-profit sector?

In the case of a hospital, the exception for articles generally used by or for inpatients would effectively void the general rule of taxability. Hospital gift shop purchases will undoubtedly be claimed for inpatient use, regardless of whether the purchaser is an outpatient, visitor, staff, or inpatient.

Similarly, excepting university sales of articles which are "in furtherance of educational programs" would merely mirror the present "convenience" exception which is proposed to be repealed. Are sales of books which are not required for classroom instruction to be considered "in furtherance of educational programs?" Are sales of soccer balls for intramural college sports programs taxable? The exception also permits a bookstore to sell one computer per student/faculty each year. Would computer software similarly be tax-exempt?

Finally, excepting "off-premise" sales, to the extent of "on-premise" sales, would allow an intolerable amount of unrelated commercial income to escape taxation. As indicated in the example provided by the Subcommittee, through this so-called "de minimus" exception universities can earn the right to generate a dollar of tax-free off-campus income for every dollar earned from on-campus tax-free sales. For some universities, the "de minimus" exception will amount to a substantial reduction in taxes on off-campus sales, excluding hundreds of thousands of dollars of otherwise taxable income.

B. UBIT would apply to all sales or rental income of medical equipment and devices, laboratory testing, and pharmaceutical drugs and goods, with exceptions for (1) inpatients, continuous-care outpatients, or emergency treatment outpatients, or (2) items not available in the immediate geographic area. I support this change, but I strongly urge that the exception for continuous-care outpatients be carefully defined and the exception for items not available in an immediate geographic area eliminated.

If restrictions are not placed on the definition of a continuous-care patient, nonprofit health care facilities would be provided indefinitely with a captive market for sales. The Supreme Court's decision in Abbott Laboratories, et al v. Portland Retail Druggists Assn., Inc. may provide some guidance.[5] There a patient was considered to be under continuous care when released from the hospital and given a take-home prescription intended for a limited and reasonable time, as a continuation, or supplement to, treatment administered at the hospital.

The Subcommittee should also recognize that excepting items not available in an immediate geographic area would likely serve as a barrier to entry for small businesses. This rule would effectively result in taxability of the sale of a commercial article determined by whether the first vendor in a geographic area was a nonprofit or for-profit. It would also engage courts in geographic arguments of relevant market. Small businesses are highly flexible and competitive. To the extent that demand exists, small firms will form to meet such demand, unless artificial barriers, such as the tax exemption of a competitor deter them from doing so. The exception is not necessary, does not make good policy sense and would be difficult to define.

C. Applying UBIT to income from certain health, fitness, exercise and similar activities, unless the program is available to a reasonable cross-section of the general public, such as by scholarship or fees based on community affordability, does little to change current law. A YMCA located in a high-income area may offer services to a nondiverse, yet "reasonable cross-section" of the public, and charge a fee which may be beyond the reach of most taxpayers, but in line with the area's income level. Activities generating this YMCA's income may be identical in nature to that of a for-profit, yet the YMCA's income would remain tax-free under this exception. The requirement that health, fitness or exercise facilities be available to a "reasonable cross-section of the general public," would be satisfied by many for-profit businesses. This test is an easy and imprecise standard for tax exempt fitness activities to meet.

It should also be noted that the primary justification for subsidizing health and fitness facilities is that they serve the needy. However, considerably fewer restrictions are imposed on the use of this subsidy than are imposed on other tax incentives designed to assist the needy, such as the low-income housing credit. A rental project providing low-income housing, for example, qualifies for the low-income housing credit only if: (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of area median income, as adjusted for family size, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income, as adjusted for family size (I.R.C. § 42). These restrictions are designed to ensure that the benefits of the subsidy actually reach the intended parties.

Although the relative area median test, in application to the housing credit, may allow for some abuses, it does indicate that there are ways to develop measurement standards. The same type of restrictions which safeguard the integrity of the tax credit for low-income housing should apply to health facilities whose subsidization is based on assistance to economically disadvantaged individuals.

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[5] 425 U.S. 1, (1976). Abbott Laboratories concerned the scope of an exemption provided in the Nonprofit Institutions Act (15 U.S.C. § 13c) from the application of the Robinson-Patman Price Discrimination Act (Robinson-Patman; 15 U.S.C. § 13(a)).

D. UBIT would apply to travel and tour services, except services provided by colleges or universities to students or faculty as part of a degree program curriculum, as well as de minimus sales. I support the exception for services that are part of a degree program. According to the example provided by the Subcommittee, however, the exception for de minimus sales of travel and tour services would allow colleges and universities to avoid taxes on sales to alumni and other outside parties, so long as the sales are not in excess of on-campus sales. Under this exception, therefore, a significant amount of off-campus travel or tour services would escape taxation, even though the off-campus services are readily provided by their for-profit competitors and have little to no educational component.

E. No comment.

F. UBIT would apply to income from certain veterinary services such as grooming, boarding, and elective surgery, with exceptions for spaying and neutering, services to protect the public health, and measures recommended by a veterinarian for the health of the animal. This latter exception, i.e. for the "health of the animal," mitigates the purpose of the rule. Almost all veterinary services can be justified on the grounds they are recommended for the "health of the animal" or to "protect the public." As a result, the exception is so broad that little is left of the rule. The preferred approach would be to limit exempt services to: (1) a shelter's own animals; (2) low-income pet owners; (3) care conducted by a veterinary school for direct educational purposes; and (4) spaying and neutering for pet population control.

G. No comment.

H. UBIT would apply to routine testing income, with exceptions for government mandated activity, pre-surgical medical testing, and laboratory testing which is part of a student educational program. While this is a useful change, the exception for student educational programs should be eliminated. Such an exception would allow universities to use chemistry students to conduct chemical analysis of industrial waste products or other "tests". Testing services offered to the public are "inherently commercial" in nature and, therefore, should normally be taxable. In addition, I question the rationale of exempting government mandated testing. Government has every right to mandate that testing be done, but there is no convincing reason to advantage a nonprofit testing operation against the for-profit testing organization.

I. - K. No comment.

L. UBIT would apply to additional specified activities determined to be inherently commercial. This illustrates the point that some items may be inadvertently excluded or are impossible to predict. Selecting an "inherently commercial" test is laudable in that it sends a message to the courts and enforcement officials that some type of restrictions are to be placed on tax-exempt organizations' commercial activities. The test, however, fails to clearly define what unspecified activities may be deemed "inherently commercial" and establishes overly generous exceptions.

III The "convenience" exception should be repealed, and broad exceptions contained in other sections should be eliminated.

If the "inherently commercial" test is adopted, broad exceptions that effectively reinstate the "convenience" exception should be eliminated. Exceptions for items I. A, B, E, and G generally rely on a rationale for tax-exemption that is indistinguishable from the justification used to support the "convenience" exception. The "convenience" exception has contributed significantly to the problem of unfair competition. Weakening its repeal by allowing for broad exceptions would perpetuate many of these problems.

IV. Better data collection and analyses are required and the IRS should be requested to develop specific changes to Forms 990 and 990-T.

Representatives of both tax-exempt and taxable organizations agree that the key to examining the extent of unfair competition is additional data collection. Presently, however, the IRS nonprofit forms do not request sufficient information to determine the sources or amounts of nonprofit commercial activity. Neither do these forms distinguish between activities that are related, unrelated, or excepted for purposes of applying the UBIT. According to a recent paper authored by staff from the Office of Tax Analysis, Department of Treasury, and Statistics of Income Division of the IRS, "while the Form 990 is quite lengthy, it is not very helpful to the IRS as an audit tool."[6] I support the Subcommittee's propósal to improve collection and analyses of tax-exempt data.

I would suggest, however, that specific guidelines be developed for modifying the tax-exempt data collection instruments. In particular, Form 990 should separate commercial income by activity into categories defined by the Internal Revenue Code (i.e., related, unrelated, or excepted).

Similarly, Form 990-T should link the source of unrelated income to the amount it generates. The Office of Advocacy is working with the IRS, representatives of the accounting profession and the tax-exempt community to develop specific reporting changes to these forms that are not unduly burdensome. Additionally, we have requested that the Commissioner's Exempt Organization Advisory Group address the question of modification to the forms. We would welcome the opportunity to share our specific proposals for changing the form with the Subcommittee.

Along with the need to improve data collection is the need to improve statistical programs that analyze such data. Requiring annual reports on samples from filed Forms 990 and 990-T would provide a time series of information useful for enforcement and policy purposes. According to the paper cited above, "improved data collection would allow the [IRS] exempt organization personnel to develop a more systematic approach to selecting exempt organization returns for audit."[7] The paper proposes improvements in the data collection program, including a proposed timetable for completion. Their recommendations include: (1) annual studies of private foundations and nonprofit charitable organizations; (2) increased sample sizes for both private foundations and nonprofit charitable organizations; (3) new sample selection criteria; (4) an examination of all 501(c) organizations, rather than just 501(c)(3) charities; (5) an annual study of Form 990-T; and (6) studies every three years on farmer's cooperatives, charitable and split-interest trusts, and exempt organization excise taxes. Additional resources would likely be needed to implement these proposals. Given the current lack of available data collected and analyzed, the benefits of funding such projects are well worth the price.

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[6] Shiff and Huffman, p. 5-7.

[7] Schiff and Huffman, pg. 2.

Data for establishing a ceiling for determining the level of questionable tax-exempt commercial activity.

Prohibiting unbridled tax-exempt commercial activity, regardless of whether the activity is related or not, is essential for minimizing unfair competition. Initiating new data collection efforts with a view toward establishing appropriate parameters for an acceptable level of commercial activity should begin now.

As indicated in my testimony, I support the development of a ceiling, which if exceeded, would shift the burden of proof to the organization to show that it is still deserving of tax-exempt status. In the absence of a clearly defined ceiling, nonprofits can engage in an almost unlimited amount of commercial activity.[8] In fact, in 1983 dues and assessments, gifts, grants, and contributions accounted for only one-third of the total revenue of charitable tax-exempt organizations. The remaining two-thirds ($148 billion) came from program services, which include both related and unrelated commercial income.[9] Our recommendations for data reform would prove useful in establishing such a ceiling.

Data for estimating Federal revenue subsidies to tax exempts.

Finally, additional data are also needed on the extent of tax subsidies to tax-exempt organizations. The Congressional Budget Act of 1974 (P.L. 93-344) requires a listing of tax expenditures in the annual Budget analysis. The "tax expenditures" are defined to include "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income, or which provide a special credit, a preferential rate of tax, or a defense of liability." Included as "taxpaying units" subject to the expenditure analysis are "...corporations where activities and ownership meet the requirements of Section 501..."[10] Revenue losses for the nonprofit sector should be estimated by the Federal Government in the same manner as are other tax subsidies.

V. An IRS administrative channel should be established to offer a mechanism through which taxable organizations can allege unfair competition in order to target noncompliance with the UBIT.

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[8] Presbyterian & Reformed Publishing Co., 743 F.2d 148 (3rd Cir. 1984).

[9] Nonprofit Charitable Organizations, 1983, Cecelia Hilgert, IRS Statistics of Income Bulletin, Spring 1987, Vol. 6, No. 4, p. 31.

[10] Special Analysis, The Budget of the United States Government, Fiscal Year 1987, Special Analysis G.

As outlined in my testimony, I strongly urge the Subcommittee to create an administrative channel for filing complaints relating to the commercial activities of tax-exempt organizations. The purpose for enacting the UBIT was to prevent tax-exempt organizations from using their tax-exempt status to gain unfair advantages over taxable organizations when both parties are engaged in identical or similar commercial activities. For-profit businesses, for whom this protection was imposed, are often in the best position to identify potential violations of the law. Yet, no effective mechanism exists whereby businesses can alert the Service to instances of potential violations. The spirit of the UBIT and administrative efficiency can be better served if the I.R.S. has access to information targeting potential noncompliance with the law. If the Service maintains that existing channels are adequate, it should publicize the availability and effectiveness of those channels.

VI. The exemption for "testing for the public safety" is no longer warranted and should be eliminated.

The miscellaneous discussion options include the modification of rules applicable to organizations "testing for the public safety" under I.R.C. Section 501(c)(3). This exemption should be eliminated. Many small for-profit laboratories are unable to compete -- or are discouraged from expanding their business -- because of the existence of large tax-exempt testing labs. The exemption was initially established to develop safety standards independent of commercial interests at a time when such standards did not exist. The marketplace has changed considerably, however, since this tax-exempt category was created. Today, many safety standards have been established, eliminating the rationale for encouraging the nonprofit sector to perform public safety tests. In fact, many testing standards set by the government (e.g., automobiles, chemicals, food and drugs) are now incorporated into for-profit firms' costs of doing business. The proliferation of for-profit firms capable of performing testing for the public safety obviates the need to preserve the tax-exemption.

VII. The research exception for colleges, universities, and hospitals should be narrowed.

Presently, nonprofit scientific organizations and organizations operating primarily for purposes of carrying on fundamental research must make research results freely available to the general public (I.R.C. § 512(b)(9)). The same treatment should be accorded contract income earned by colleges, universities, and hospitals for research projects. Income from research projects in which the results are freely available to the public should remain tax-exempt, while research performed under a contract or institutional policy that would delay publication of the results or require any resulting copyrights or patents to be transferred to the research sponsor should be taxable. With such a standard, research for the general advance of knowledge would not likely be taxed but revenues from research with practical application would likely be taxed. This approach is also consistent with the treatment of nonprofit scientific organizations.

VIII. The "volunteer labor" exception should not be permitted for activities that would otherwise be taxed under an "inherently commercial" test.

If the Subcommittee does adopt an "inherently commercial" test, the volunteer labor exception should not be available to avoid paying taxes on an activity that would otherwise be subject to the UBIT under items A. through L. For example, if gift shop sales to visitors would normally be taxed, but the volunteer exception allows the sales to avoid the UBIT, the exception should not apply. If the volunteer exception is used to circumvent a tightening of the unrelated business income tax, it effectively renders any changes meaningless. The basic rationale underlying the "volunteer labor" exception is to minimize an organization's costs, not to maximize profit margins on commercial activities.

CONCLUSION

I appreciate the opportunity to comment on the Subcommittee's discussion options relating to the UBIT. I believe that the recommendations proposed here and in my testimony would further strengthen the spirit of the unrelated business income tax laws.

If I can provide any additional information, please do not hesitate to contact me or my staff. I look forward to the Subcommittee's forthcoming report.

Yours very truly,

Frank S. Swain

Frank S. Swain
Chief Counsel for Advocacy

A-Martin Hearing Aid Center
COURT OF KING OF PRUSSIA
(IN THE AMERICAN VISION CENTER)
403 GODDARD BLVD.
KING OF PRUSSIA, PA 19406
265-0515

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Leonard:

I commend you and the Subcommittee for proposing an excellent package on the UBIT on reform measures in its final report. I urge you to apply UBIT to all hearing aid sales income of nonprofits. I also feel that the Subcommittee should repeal the existing "convenience" exemptions for patients or recognize patients as inpatients only.

I wish to thank you for your consideration and urge you to make the reform necessary to fair competition in the market place.

Very truly yours,

Marty Slomine

Martin Slomine
National Board Certified
Hearing Instrument Specialist

MS:aws

Accurate Hearing Aid Centers, Inc.
3397 North High Street
Columbus, Ohio 43202
April 12, 1988

Honorable J. J. Pickle, Chairman Ways & Means Oversight Committee
U. S. House of Representatives
1102 Longworth House Office Bldg
Washington, D.C. 20515

Dear Mr. Pickle,

We are pleased to see that action is being taken to reform the UBIT system.

We are a small business and have always been concerned about non-profit organizations that are in direct competition with tax-paying businesses.

The reform measures appear to deal thoroughly with the problem, and we trust that they will be adopted "in toto".

We are particularly concerned with this type of competition within our own field which is the sale and fitting of hearing aids, and feel strongly that these regulations need to be applied to commercial hearing aid sales that are made by non-profit facilities.

We have lost business to several of these facilities in our area and generally find that these lost clients bought from the non-profit organizations for a number of reasons, such as lower cost. The Federal Government certainly should not encourage this competition by allowing these non-profits to operate on a tax-free basis.

Our fitting procedures involve complete audiology, providing the hearing aid, dispensing and fitting it, and all follow-up service at one price. Once our fitting costs have been deducted, we pay taxes on the profit. This has always been the principal of the free enterprise system make a profit and pay taxes! Since many of these "non-profits" are in fact selling hearing services and products and realizing a profit on these specific items, they should pay taxes on these items. This type of sale is basically commercial in nature and should be taxed accordingly.

Please find enclosed a copy of the report showing the United Way funds given to the Columbus Hearing & Speech Center, which dispenses hearing aids-some below our cost from the manufacturers. They also have access to a mobile hearing test unit which belongs to the State of Ohio. They use this unit in shopping centers to promote business for the Columbus Hearing & Speech Center.

A group of otolaryngologists at Ohio State University have formed a corporation using Ohio State University's name and dispenses hearing aids using the students of Audiology to test and fit hearing aids. This would be bad enough; however, it is our understanding there is no charge to them by the university for office space or equipment use.

The above are just a few cases in point.

We urge the Sub-Committee to apply UBIT to all commercial sale of hearing aids for profit, and also to repeal the "convenience" exemption for patients or to recognize patients as in-patients only.

Thank you for your consideration.

Very Truly Yours,

M L Zimmerman

M. L. Zimmerman, President
Accurate Hearing Aid Centers, Inc.
Certified NBC-HIS

TOP 25 UNITED WAY BENEFICIARIES

Ranked by 1987 Allocation

	Name Address Phone	1987 Allocation	1986 Allocation	Executive Director	Description of Services	1986 Total Revenue	Chief Volunteer Officer	Year Established
1.	American Red Cross 995 E. Broad St. Columbus, 43205 253-7981	*$1.69 million	*$1.38 million	Dean Dugger	[illegible]	[illegible]	[illegible]	[illegible]
2.	Young Men's Christian Association 40 W. Long St. Columbus, 43215 224-1142	$728,731	$685,860	Jerry Garver	Camping; cultural, recreational programs; family life education; social development; preventive health care; residence facilities; corporate programs; male and female members.	$4.92 million	James Grote	[illegible]
3.	Life Care Alliance 303 E. Sixth Ave. Columbus, 43201 294-3191	$720,880	NA	Linda Farrell	Meals-On-Wheels; home health nurses; [illegible]	[illegible]	James [illegible]	[illegible]
4.	Family Counseling & Crittenton Services 185 S. Fifth St. Columbus, 43215	$702,780	$640,510	William White	Professional counseling for personal problems, family and marriage conflicts, parent/child relationships, chronic illness stress, problem pregnancy; financial management; substance abuse; family and parent education; foster care; residential care; education; counseling and medical assistance for unmarried mothers.	$1.88 million	NA	[illegible]
5.	Catholic Social Services 197 E. Gay St. Columbus, 43215 221-5891	$701,410	$701,410	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6.	Columbus Urban League 700 Bryden Road Suite 200 Columbus, 43215	[illegible]	[illegible]	Samuel Gresham Jr.	Advocacy of equal participation of blacks and other minorities in all phases of community life; housing assistance; job training and employment; word processing training; family information and resource center; summer youth programs; research to influence social policy program decisions on minority issues.	$1.45 million	Jack Marbury	[illegible]
7.	American Cancer Society 880 Michigan Ave. Columbus, 43215	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
8.	Boy Scouts of America, Central Ohio Council 1901 E. Dublin-Granville Road Columbus, 43229	[illegible]	$478,215	[illegible]	Recreation, cultural and educational programs for boys and girls ages 8-18; tutoring and career guidance.	[illegible]	[illegible]	[illegible]
9.	United Cerebral Palsy of Columbus and Franklin County 2980 Valleyview Drive Columbus, 43204 279-0109	[illegible]	[illegible]	[illegible]	Adult rehabilitation and residential programs; [illegible]	[illegible]	[illegible]	[illegible]
10.	Neighborhood House 1000 Atcheson St. Columbus, 43203 252-4941	[illegible]	$377,312	[illegible]	Day care for children six weeks to 13 years; family-centered health care; mental health and substance abuse counseling; substance abuse information and education; neighborhood improvement; social development activities for youth in the east side; emergency assistance.	$1.2 million	Al White	[illegible]
11.	Westside/Eastside Childcare Centers Association 40 W. Grubb St. Columbus, 43215	[illegible]	[illegible]	Carl Porter	Comprehensive child care and developmental services for children ages 18 months to 10 years inclusive of special needs; educational programs; emergency care and parent skills development.	[illegible]	[illegible]	[illegible]
12.	Salvation Army 340 E. Fulton St. Columbus, 43215	$411,830	$385,172	Major David Brindley	Counseling; family life education; emergency help for family transients; disaster relief; residence facilities; senior citizens and missing persons bureau; recreation; summer youth programs.	$1.29 million	[illegible]	[illegible]
13.	St. Stephen's Community House 1500 E. 17th Ave. Columbus, 43219 294-6347	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	William Anderson	[illegible]
14.	Godman Guild Association 321 W. Second Ave. Columbus, 43201 294-5476	[illegible]	[illegible]	[illegible]	Employment counseling; camping; social development/prevention; group services programs for youth adults and families; counseling for temporary material assistance needs; neighborhood housing development.	[illegible]	Carol Brigham	[illegible]
15.	Young Women's Christian Association 65 S. Fourth St. Columbus, 43215 224-9121	[illegible]	[illegible]	Karen Schwarzwalder	Informal adult and youth education; self development and health care programs for women; physical preventive health maintenance programs; fitness, recreation and sports; public information programs and advocacy for women's issues; day care and preschool programs; residence facilities; male and female members.	[illegible]	[illegible]	[illegible]
16.	Leo Yassenoff Jewish Center 1125 College Ave Columbus, 43209	$354,042	[illegible]	Allan Finkelstein	Youth activities; day camp; preschool, senior citizen activities; educational and day care programs for handicapped children; cultural, recreational and educational activities.	[illegible]	David Milenthal	1950s
17.	South Side Settlement House 310 Innis Ave. Columbus, 43207	[illegible]	[illegible]	[illegible]	Family life education counseling; social development for youth; neighborhood development programs to residents in the south side.	$447,013	John Brody	[illegible]
18.	Jewish Family Service 1175 College Ave. Columbus, 43209 231-1890	$347,704	[illegible]	Dr. Earl Yallen	Clinical social work and vocational counseling programs; individual and family counseling; group therapy; family life education; resettlement services; adoption and foster care.	[illegible]	Henry Epstein	[illegible]
19.	American Heart Association 200 E. Rich St. Columbus, 43215 228-6327	[illegible]	[illegible]	[illegible]	Cardiovascular research; education and training of health care professionals; basic and advanced cardiac life support program; hypertension program; blood pressure screenings in businesses and schools; community service projects.	[illegible]	Dr. J.T. Huston	[illegible]
20.	Gladden Community House 183 Hawkes Ave. Columbus, 43223 221-7801	$323,315	[illegible]	[illegible]	Community services in the Franklinton area; neighborhood development; emergency assistance; information and referral; social development; group services and recreation; special education services, preschool and supplemental reading; juvenile delinquency prevention diversion.	$436,927	[illegible]	[illegible]
21.	Central Community House 1251 Bryden Road Columbus, 43205	[illegible]	[illegible]	[illegible]	Community information; youth development programs; day care; emergency assistance; counseling and neighborhood development on the east side, south of Broad Street.	[illegible]	[illegible]	[illegible]
22.	Central Ohio Lung Association 4627 Executive Drive Columbus, 43220 457-4570	$275,000	[illegible]	[illegible]	Education, service and research programs; smoking and drug prevention aimed at grades K-12; Smoking Cessation programs including classes, self-help and hypnosis; asthma education and camp for asthmatic children; Better Breathing Club for adults with chronic lung disease; crisis financial assistance [illegible] Ohio for Sudden Asthma Death.	[illegible]	Dr. John Pinton	[illegible]
23.	Columbus Speech & Hearing Center 4110 N. High St. Columbus, 43214 263-5151	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
24.	[illegible] Columbus, 43215	[illegible]	[illegible]	[illegible]	[illegible] ages 10-18; counseling; recreation; sheltered group care, prevocational training; special education, day treatment and family-based aftercare services.	[illegible]	James Jones	[illegible]
25.	Goodwill/Central Ohio Rehabilitation Center 1331 Edgehill Road Columbus, 43212 294-5181	[illegible]	[illegible]	[illegible]	Vocational training and transitional employment opportunities for people with disabilities; [illegible]	[illegible]	Gary Hall	1940s

Sources: This list was compiled with the help of the United Way of Franklin County.

Note: United Way campaign dollars are distributed by community volunteers who study the community and evaluate its current and future needs. They also review each agency, rank them according to priority and make their funding decisions based upon priority needs.

A chief volunteer officer is the president or chairperson of the agency board.

Figures for the American Red Cross, American Cancer Society and American Heart Association are for Franklin County chapters.

*Does not include Blood Program.

Mr. Otis A. Whitcomb, M.A.
President
ACI Auditory Centers
111 E. Wisconsin Avenue, Ste. 725
Milwaukee, WI 53202

April 11, 1988

The Honorable Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Reform of the Unrelated
Business Income Tax
(UBIT) System

Dear Mr. Leonard:

I am writing to express the difficulties we are having by attempting to provide hearing aid services in direct competition with clinics, hospitals, agencies and other not-for-profit facilities.

In Southeastern Wisconsin during the past five years, Milwaukee County Medical Center, Curative Workshop, St. Lukes Hospital, Trinity Memorial Hospital, and Kenosha Memorial Hospital have all started dispensing hearing aids as part of their not-for-profit out-patient departments. In all locations they offer services to the public at costs significantly lower than usual/customary retail.

Please help pass legislation that will force NOT-FOR-PROFIT institutions to compete fairly.

I had to close my Kenosha, Wisconsin small business because of hospital and HMO competition.

Thank you for addressing this important issue.

Sincerely yours,

Otis A. Whitcomb, M.A.
Audiologist

cc: Douglas Johnson
Wisconsin Merchants Federation

cc: National Hearing Aid Society

ACI Auditory Centers
100 W. Lawrence
Suite 106
Appleton, Wisconsin 54911
(414) 731-9611

April 13, 1988

J. J. Pickle, Chairman
House Ways & Means Oversight Subcommittee
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Representative Pickle:

I am writing this letter to express my concerns regarding the unfair advantage enjoyed by non profits.

Let me first express my appreciation for the time and effort given, so far, on this matter by you and your Subcommittee.

After reviewing the proposal options in press release Number 16, I find several options quite acceptable, particularly I. "Substantially Related" test.

I certainly hope that a combination of the options listed will flow through in the final recommendations.

My business is one of product and service providership to the hearing impaired population. We sell and service hearing aids and other assistive listening devices for this population.

The convenience and availability of these goods and services has never been much of a problem as many hearing aid dispensers and dispensing audiologists routinely visit hospitals, private homes and nursing homes.

When not-for-profit hospitals expanded into the sale of hearing aids, our suspicions of their long term method of operation were all too accurate.

They entered the marketplace 35 to 40 percent lower than the prevailing charges for the currently available goods and services. (Subsidized of course by the base operations of the hospitals and enjoying the tax advantage of the parent corporation.)

After several small businesses were forced to close their doors (our fourteen year old tax paying business being one of them), they immediately increased their fees by approximately 25%.

The overall result of the addition of hearing aid dispensing in this non-for-profit hospital:

a. The same number of service providers available.

b. Virtually the same cost on goods and services to the hearing impaired population.

c. A tax paying corporation and it's employees no longer on the tax rolls.

Enticement of this non profit status appears to be so great that a large regional medical facility in Central Wisconsin has recently (1988) converted to a not-for-profit status.

This trend must be stopped.

The "halo effect" of the words NON PROFIT are a lie to the American public.

These ventures are related to the "mission statement" of the original business and are not justifiable based on demonstrated market need or convenience to the hearing impaired populatic

I thank you for the opportunity to respond and will be following this issue with great personal interest.

Sincerely,

Michael Thelen, M.S. CCC-A
Clinical Audiologist

Acousticon of Texarkana
214 West Third Street
Texarkana, Texas 75501
April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

Forty years ago I graduated from college and bought this hearing aid office in Texarkana, borrowing the money from a loan on my G.I. Insurance, having been in the U.S. Navy from 1943 until 1946. Fitting and dispensing hearing aids has been hard work, requiring long hours every week to make a go of it. Even though we have paid city, county, school and state taxes on the business and our home, there has been great satisfaction in seeing our hard of hearing friends use their hearing aids to hold jobs and live normal lives.

It really gauls us at this time that the Temple Treatment Center can receive United Way funds and draw on Easter Seal money here in Texarkana, all the while selling hearing aids and batteries for profit, yet pay no city, county or school taxes. We couldn't stay open if we sold instruments $200 below suggested retail prices as they do. We KNOW what unfair competition from 'nonprofit' organizations can do for you. Rather, TO you.

We praise the House Ways and Means Oversight Subcommittee for a very fine package of reform measures. We beg you to include the Unrelated Business Income Tax system in your final report, and apply UBIT to all hearing aid sales income of nonprofits such at Temple Treatment Center.

Thank you for your help in this matter.

Sincerely yours,

A. L. Burns Jr.

A. L. Burns, Jr.

Advanced Instruments—the ultimate in better hearing

Oak Grove Medical Center, 1028 Oakgrove Rd., Suite #7, Concord, CA (415) 674-8821

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Bld.
Washington, DC 20515

Dear Mr. Jeonard:

Please apply UBIT to ALL hearing sales income of Non-Profit Organizations.

NPO's dispensing (selling) hearing aids are doing so through commercial channels. Advertising in newspapers is one such channel.

Our advertising costs are totally absorbed as part of our day-to-day expenses. A NPO is given special rates by newspapers, radio and TV stations as well as the telephone book. All of which are not available to the hearing aid dispenser without the advantages of being a NPO.

— Don't forget U.S. Mail! Pa

In the past several months two patients chose to go to the University of San Francisco Medical for their hearing aids, saying, "I can get this hearing aid for half-price."

Unfortunately, these patients do not realize they must pay for the hearing test separately from the hearing aid, as well as a fee for each visit they make for follow-up and service. The bottom line is they often pay more for the service at the NPO than with a private dispensing office.

What separates us from the NPO is that they choose to be non-profit - we don't!

Sincerely yours,

Patricia A Williams

Patricia A. Williams

THE HONORABLE J.J. PICKLE
CHAIRMAN, HOUSE WAYS AND MEANS
OVERSIGHT SUBCOMMITTEE

YOU ARE TO BE COMMENDED, MR. PICKLE,

AND YOUR COMMITTEE FOR PROPOSING AN EXCELLENT PACKAGE OF REFORM MEASURES REGARDING THE UBIT REFORMS. WE URGE THE SUBCOMMITTEE TO INCLUDE ALL THE MEASURES IN THE FINAL REPORT.

ALL NON-PROFIT ORGANIZATIONS ARE A CONCERN TO US; HOWEVER, THE DISPENSING OF HEARING INSTRUMENTS HITS US IN OUR POCKET AND TAKES THE PRIMARY CONCERN. THE NON-PROFIT ORGANIZATIONS ARE NOT DISPENSING HEARING INSTRUMENTS AS A PROJECT TO RESEARCH THE VALUE OF A HEARING INSTRUMENT TO THE HEARING IMPAIRED. THEIR GOAL IS LARGE SALARIES THAT THEY OBTAIN BY SELLING THEIR HEARING INSTRUMENTS BELOW MARKET PRICE. THE EXPENSES OF DOING BUSINESS, BY THE NON-PROFITS, IS NOT A FACTOR. THE PATIENT, HAS THE FREEDOM TO CHOOSE, BUT THE PRICE SEEMS TO BE THE PRIME CONCERN. THEY ARE UNAWARE OF THE SERVICES AND CARE THAT IS BEING FORFEITED. THE TAX PAYING DISPENSER CAN NOT FINANCIALLY COMPETE WITH THE NON-PROFIT, AND THE REASON FOR THEIR STATUS, OTHER THAN SUPPLY INSTRUMENTS AT A LOW COST, HAS NOT BEEN ESTABLISHED. THEIR ACTIVITY IS NOT LIMITED TO THE UNDERPRIVILEGED. THEY DO NOT DISPENSE FREE HEARING INSTRUMENTS. THERE ARE NO QUALIFICATIONS TO RECEIVE AN INSTRUMENT FROM THESE CONCERNS. IT IS IMPOSSIBLE TO COMPETE WITH THESE ORGANIZATIONS.

ISN'T THE BOTTOM LINE TO ALL NON-PROFIT ORGANIZATIONS THE ANSWER TO THE QUESTION, "IS THE PUBLIC BETTER OFF BECAUSE OF THE NON-PROFIT ORGANIZATIONS?" IF THAT QUESTION IS ANSWERED TRUTHFULLY, Then WOULD BE VERY FEW QUALIFYING TO RECEIVE THE EXEMPTION.

HOSPITALS SPEND MONEY BUYING APARTMENT HOUSES TO RENT, INCLUDING ONE FREE MEAL WITH THE RENT. THERE ARE NO QUALIFICATIONS, AS FAR AS INCOME TO BE ABLE TO RENT ONE OF THESE APARTMENTS, NOR DO THEY HAVE TO HAVE A PATIENT IN THE HOSPITAL. DIRECT COMPETION TO LOCAL RENTALS. WINE PARTIES INCLUDED WITH CONTINUING EDUCATION PROGRAMS AT NO CHARGE. THIS SPENDING OF MONIES, TO BE SURE TO MEET THE NON-PROFIT REQUIREMENTS, WHILE PATIENT CARE DEGENERATES, COST INCREASES, AND THE INDIGENT IS IGNORED DOES NOT MEET THE QUESTION, " IS THE GENERAL PUBLIC BETTER OFF?".

THE REPORTED STATICS ABOUT THE QUALITY OF EDUCATION IS DEPLORABLE. THE UNIVERSITIES ARE ENTERING INTO COMPETITION WITH THE PRIVATE SECTOR IN MOST FIELDS; SOFT WARE FOR COMPUTERS, PHARMACY, VETERINARY MEDICINE, DISPENSING HEARING INSTRUMENTS, AND RENTAL OF THE DORMITORIES DURING THE OFF CAMPUS TIME AT RIDICULOUSLY LOW FEES TO LARGE ORGANIZATIONS, TAKING THE OPPORTUNITY FROM THE MOTEL/HOTEL OPERATORS TO RECEIVE THE INCOME. THE EDUCATIONAL SYSTEM HAS NOT BEEN BETTER SERVED BY COLLEGES AND UNIVERSITIES ENTERING COMPETITIVE MARKETS WITH A NONPROFIT STATUS.

THE GENERAL PUBLIC HAS BEEN HURT BY THE NONPROFIT STATUS OF THE RELIGIOUS ORGANIZATIONS. THE NEWS IS REPLETE WITH THE EXPENDITURES OF THESE GROUPS, CLAIMING NONPROFIT STATUS.

WE URGE THE SUBCOMMITTEE TO REPEAL THE EXISTING "CONVENIENCE" EXEMPTION FOR PATIENTS OR RECOGNIZE PATIENTS AS INPATIENTS ONLY.

THE PRESSURES BEING PLACED ON YOUR SUBCOMMITTEE BY BOTH FACTIONS ARE CONSIDERABLE. WE URGE YOU TO CONSIDER THE ACCOMPLISHMENTS OF THE "NONPROFIT" ORGANIZATIONS. IT IS OUR EXPERIENCE THAT THE GOOD OF THE PUBLIC HAS BEEN HARMED BY THIS PRIVILEGED.

THANK YOU FOR CONSIDERING OUR INTEREST IN THIS LEGISLATION.

Jack Agee
Jean Agee

JACK AGEE
JEAN AGEE
201 W. 8TH ST., #680
PUEBLO, CO 81003

Akron
Symphony
Orchestra

Alan Balter
Music Director & Conductor

AKRON SYMPHONY CHORUS
James Mismas, Director
AKRON YOUTH SYMPHONY
John Morris Russell, Conductor
Sponsored by Greater Akron Musical Association, Inc.

Robert R. Neu
General Manager

April 11, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I am writing to you in regards to the deliberations currently being undertaken by the House Ways and Means Subcommittee on Oversight on options for legislative action on the Unrelated Business Income Tax.

The options currently under consideration would be disastrous for nonprofit arts groups. As you well know, these are difficult times for American orchestras, theatres, dance ensembles and museums - each of us does everything possible to maintain a balanced budget and to produce the greatest possible amount of earned income. The prospect of losing our tax-exempt status, even on some items, is a very serious one. The Akron Symphony Orchestra, in particular, is managed in accordance with a long-range plan which mandates a substantial growth in its income from ticket sales, advertising and gift shop sales - this in order to balance out a potential over-dependency on state, federal, corporate, foundation and private monies. In other words, the Akron Symphony wants to be as self-supporting as possible. To threaten this base of support with the possibility of built-in expenses by virture of the options relating to UBIT is to threaten the livelihood and growth of what is currently a thriving arts organization.

I ask that you and the House Ways and Means Subcommittee on Oversight seriously consider the options on UBIT and seriously consider the ramifications this particular tax would have, not just for the Akron Symphony Orchestra, but for every nonprofit arts organization in this country.

Respectfully yours,

Robert R. Neu
General Manager

RRN/clw

STATEMENT OF
TOMMY R. MCDOUGAL
PRESIDENT
ALABAMA HOSPITAL ASSOCIATION

I am Tommy R. McDougal, President of the Alabama Hospital Association (AlaHA). On behalf of the thirty eight (38) not-for-profit hospital members of the Alabama Hospital Association, I appreciate the opportunity to submit comments on the discussion options regarding the unrelated business income tax (UBIT) under consideration by the House Ways and Means Oversight Subcommittee.

The ability of Alabama not-for-profit hospitals to continue delivering high-quality health care to our patients and the communities they serve would be in serious jeopardy if these options are enacted. In fact, the Association has serious reservations about a number of the Subcommittee's discussion options, and urges the Subcommittee to give careful, studied consideration to each and their consequent effect on the delivery of health care before recommending changes in the UBIT law.

Most importantly, the Association believes that the Subcommittee's discussion options are very pervasive. They attack every aspect of the revenue stream relied upon by our not-for-profit hospitals and represent a total overhaul of the way they operate. The options will have a severe impact on our not-for-profit hospitals' ability to serve their exempt purposes and, ultimately, their patients.

THE MISSION OF NOT-FOR-PROFIT HEALTH CARE PROVIDERS

It is essential that the Subcommittee examine UBIT-related questions in the context of a clear understanding of the special health care mission of the voluntary, not-for-profit health care provider and the increasingly complex and challenging environment in which they must carry out that mission.

Not-for-profit health care institutions have provided access to health care for those unable to pay by employing community volunteers, soliciting community charitable donations, and cross-subsidizing those services provided at no fee or at a reduced fee or are otherwise inadequately reimbursed with fees charged other patients for other services. Data from the American Hospital Association show that 73% of hospital uncompensated care is provided by nongovernmental, not-for-profit hospitals. The cost of providing uncompensated care in Alabama has grown to $260 million annually, or 12% of their total expenses.

The not-for-profit hospital has been accorded special tax status because of its commitment to a broad range of charitable purposes and essential community responsibilities. The goal of the voluntary community hospital is to maintain and improve the health status of all of the citizens in its community by offering whatever health care services are needed, irrespective of whether or not the recipient can pay or whether the costs of such services can be recovered. The community service commitment of voluntary hospitals also frequently includes, in addition to providing personal health care services, major responsibilities for the training of health care professionals, the conduct of research to improve the quality of medical knowledge, and the health education of patients, their families, and the community at large.

The reasons for which hospitals engage in activities outside their traditional role of providing inpatient care are many. These activities are, and must be, ultimately in furtherance of the tax-exempt purpose and goal of all hospitals - the promotion of health. The public's interests are served when hospitals go outside their role of acute-care providers to operate or cooperate in diversified activities within the health care arena.

To the extent that there are surface similiarities with for-profit business and health care providers today, these result primarily from the enormous pressures from the Federal Government and private sector payors to become more "competitive." It would be ironic indeed if the Congress were to alter the tax treatment of not-for-profit institutions because of perceived similarities with the for-profit sector, when the Federal Government has created or encouraged the principle environmental changes which have led to this change in the surface appearance of our institutions.

Over the past few years, the Federal Government has proceeded to force further major economies in the health care sector by reducing annual Medicare payment increases below the increases in the prices of hospital inputs. Last year the Congress also reduced payments for hospital capital expenditures below actual costs. Because of these influences, and in order to survive, not-for-profit hospitals must be engaged in "income-producing" activities. Virtually any tax-exempt organization which is not engaged in such activities in today's environment of shrinking charitable giving and government reimbursement may not be able to perform its exempt purpose.

THE UNRELATED BUSINESS INCOME TAX

In 1950, Congress enacted legislation that imposed the unrelated business income tax, a tax on income from activities not substantially related to the tax-exempt organization's purpose. This legislation was to address a perceived unfair competitive advantage enjoyed by certain tax-exempt organizations and to prevent a potential loss of tax revenue. The tax was not imposed on income derived from any activity related to an organization's exempt purpose regardless of its competitive nature.

In enacting the UBIT law, Congress did not intend to eliminate all competition between tax-exempt and tax-paying entities. Rather it recognized that tax-exempt organizations may engage in income-producing activities in furtherance of their exempt purposes, and that this should be allowed without taxing the income from these activities if they meet the test of relatedness to the organization's exempt purpose. Indeed, Congress permitted tax-exempt entities to engage even in activities unrelated to their exempt purpose as long as tax is paid on the income from such activities and the activities do not constitute a substantial part of the activities of the exempt organization.

The Association has always supported this approach. We believe that it accurately reflects the reality that there are a wide variety of exempt activities being conducted by tax-exempt organizations today, and that these activities and their implications change over time. The fact that the UBIT law has functioned so well, despite the great changes in health care needs and the health services environment is strong evidence that the criteria of the UBIT test and the way it is implemented is appropriate.

It is worth repeating that UBIT was not intended to have an effect on the tax-exempt status of qualified organizations, nor does it preclude such entities from engaging in certain kinds of activities. But, it is intended to impose comparable taxes on unrelated commerical activity that are comparable to those imposed on taxable entities. The Association thinks this is appropriate.

THE "SUBSTANTIALLY RELATED" TEST

The Association has serious reservations about the Subcommittee's proposal to eliminate the "substantially related" test and replace it with a "directly related" test. Equally disturbing is the option to retain the "substantially related" test, but to impose UBIT on specified activities (i.e., "unsafe harbors") whose nature and scope are inherently commerical, rather than charitable.

These changes would call for the application of the UBIT to gift shop sales (with exceptions for articles generally used by or for inpatients); to all sales or rental income of medical equipment and devices, laboratory testing, and pharmaceutical drugs and goods (with exceptions for inpatients, continuous-care outpatients, or emergency treatment patients, or items not available in the immediate geographic area); to income from certain health, fitness, and similar activities; to adjunct food sales (with exception for on-premise services); to hotel facility income which is patronized by the public; and to additional specified activities determined to be "inherently commercial."

Under current law, the test to determine whether a business activity is or is not "substantially related" requires an examination of the relationship between the business activities which generate the particular income in question and the accomplishment of the organization's exempt purpose. The activities which generate the income must contribute importantly to the accomplishment of the organization's exempt purposes to be substantially related.

During testimony to the Subcommittee on Oversight on June 22, 1987, the Treasury Department acknowledged that the "substantially related" test has "conceptual merit" but expressed reservations about "its inherent generality [as] a source of administrative difficulty." Instead of abandoning the substantially related test, the Treasury Department recommended "obtaining more detailed information concerning the revenues of exempt organizations and the basis of treating them as tax exempt."

We agree. The alleged abuses in this area do not justify the abandonment of the "substantially related" test for other tests, such as whether the activity is "directy related," whether the income producing activity standing alone is tax exempt, or whether the activity is inherently commerical (as defined by the unsafe harbors) or charitable.

These tests are at least as subjective as the substantially related test; any such change in the language of the test would result in years of uncertainty as new interpretations define the contours of the new standard. Moreover, it is extremely unlikely that any reduction in competition with for-profit businesses or increased UBIT tax revenues would justify the costs to both tax-exempt and taxable businesses of changing the test.

The Association believes that more effective application of the existing "substantially related" test is preferable to the development of some new subjective untested standards. Also, improved enforcement by the Internal Revenue Service and more detailed compliance by the tax exempt sector would be a more effective approach to concerns raised in this area.

THE "CONVENIENCE" EXCEPTION

The Subcommittee also proposes to repeal the "convenience" exception. Under current law, any trade or business carried on by a Internal Revenue Code 501(c)(3) organization primarily for the convenience of its members, students, patients, officers, or employees is not unrelated trade or business. The Association believes that the convenience exception makes good sense and should not be repealed. Conveniences such as employee cafeterias, vending machines, gift shops, pharmacy, parking lots, staff residences, etc. are not provided to the hospital's staff, students, physicians or patients because they produce revenue. Rather, the services are prôvided because they contribute importantly to the functioning of the hospital. These conveniences certainly enhance the delivery of health care services to our patients.

Establishing new, complex rules to determine whether specific transactions are related to specific kinds of patients (e.g., the patient is an inpatient, the patient is a "continuous care" outpatient, etc.) is unwarranted and unnecessary, and would impose additional administrative burdens on hospitals and the government.

Finally, there are a number of other ambiguities contained in the Subcommittee's proposals which signal caution. One example is the Subcommittee's use of the phrase "continuous care" outpatient without specification or definition. The application of UBIT to income generated from sales to such individuals would appear to be overreaching and overly broad without a concise and applicable definition of the terms.

TAXATION OF SUBSIDIARIES

Perhaps the Subcommittee proposals that generate the most concern among the not-for-profit hospitals in Alabama are those regarding subsidiaries and joint ventures. The Subcommittee proposes to modify the definition of "control" in the case of exempt organizations having taxable subsidiaries; extend the "control" rules where exempt organizations in the aggregate own more than 50% of the subsidiary's stock; provide that a controlled taxable subsidiary's income can be no less than its UBIT would have been if the income-producing activity had been carried on directly by the exempt organization; and aggregate income and activities of controlled subsidiaries for purposes of determining if the primary purpose of the parent organization is a tax-exempt purpose.

Through the creation of for-profit subsidiaries, which pay taxes on their net income before the after-tax income goes to the not-for-profit hospital, our not-for-profit providers have been able to integrate into our total health care system certain services in which they otherwise would be unable to participate. This is because the amount of unrelated income from these services within the tax-exempt hospital would have jeopardized their tax exemption.

Present law allows taxable subsidiaries to offset income with losses from activities whether or not they could qualify for exempt status on their own. We believe this is fair and workable.

One of the Subcommittee's proposed options would provide that a controlled taxable subsidiary's income could be no less than its unrelated business income would have been if the income-producing activity had been carried on directly by the exempt parent organization. The effect of this option is very unclear, but it is potentially explosive. Tax exempt organizations would be placed at a tax disadvantage as a result; in effect, the government would essentially be collapsing the corporate structure for tax purposes and in a manner unfair to tax exempt organizations.

Moreover as written, the proposal would prevent the subsidiary from deducting at its level payments of interest, rents, royalties, (which are normally deductible expenses of a taxable business) even though those same amounts would also be taxable to the parent organization.

AGGREGATION

The Subcommittee proposes to aggregate the income and activities of controlled subsidiaries with the activities of an exempt parent for purposes of determining whether the parent's activities are primarily charitable. Where a taxable business is separately incorporated and its books and records are separately accounted for, we do not believe that there is any reason to treat such a business as if its activities were conducted directly by the exempt parent.

This change would affect not merely the net income derived from unrelated business, but the very exemption of the parent. Many exempt organizations, particularly in the health care field, have set up controlled taxable subsidiaries to conduct certain activities that would, in most cases at least, be subject to unrelated income tax if conducted directly. Under current law, doing so does not normally affect the tax cost (relative to direct operations), but it does insure that the subsidiary's activity cannot jeopardize the exempt status of the parent.

The proposed change would eliminate that "safe harbor." The practical effect of the provision would depend heavily on what definition was applied to determining whether a purpose is "primary." Similarly, the significance of the proposal would be determined in part by the rules to be applied in determining whether an activity of the subsidiary was related to the purpose of the parent.

JOINT VENTURES

Under current law, joint ventures are subject to a test of relatedness to the hospital's exempt purposes, and, if unrelated, to tax on the income from the venture. A number of hospitals in Alabama have reorganized to create a structure which typically includes a not-for-profit parent, a not-for-profit hospitals, and a not-for-profit foundation, and perhaps one or more affiliates, either not-for-profit or for-profit. There are several reasons for these restructurings. Where the new activities are subject to rules and regulations different from those applicable to acute care hospitals, the separation of these activities into discrete entities facilitates management and compliance with differing regulatory environments.

Among other things, joint ventures are an important method of creating and maintaining critical ties with alternate delivery and financing entities such as HMOs, PPOs, ambulatory clinics, home health programs, and ties with physicians or physician groups. Such ventures have important primary purposes other than revenue-raising, and not all joint ventures will involve the delivery of health care services. Examples include: a partnership with a group of radiologists to purchase a CAT scanner that hospital patients will use; a joint venture to open a drug rehabilitation clinic may be designed to ensure continued access to post-acute care services; a venture to purchase a medical office building near the hospital may have the multiple purposes of providing convenient access to physicians by patients, beneficial proximity of physicians to the hospital, as well as a source of revenue.

The Association believes that these types of responses to the increasing health care needs of the communities our not-for-profit hospitals serve are fully consistent with our hospital's charitable purposes. Indeed, they are in some cases necessary to perform the hospital's mission.

The Association believes that the hospital industry's structuring of activities as joint ventures is, and should continue to be, appropriately subject to the current unrelated business income provisions. It is important to the future of high quality health care delivered at reasonable costs for hospitals to have the flexibility in structuring diverse activities to respond to community needs, to attract patients, and to use their facilities efficiently.

ALLOCATION RULES

When a tax-exempt entity engages in an unrelated trade or business, current law provides that the gross income derived from such activity (less allowable deductions "directly connected" with the carrying on of such business) will be computed for Federal income tax purposes as if it were a taxable business. Regulations provide that where facilities and personnel are used both to carry on exempt activities and to conduct unrelated business activities, expenses, depreciation and similar items, like overhead, are to be allocated between the two uses on a reasonable basis. These standards, which are both fair and practical, serve the purpose of placing the exempt organization, as to its unrelated activities, on par with taxable business.

The Subcommittee option suggests two particular accounting changes: one that would require allocation of expenses based on theoretical potential use rather than actual use of facilities; and the other to limit the aggregate deductions available with respect to an unrelated business activity. Specifically, the Subcommittee provides with respect to facilities used for exempt purposes as well as unrelated business purposes, a deduction against UBI for a proportionate share of the direct-operating cost of the facility (e.g., maintenance, insurance, and utilities), but does not allow a deduction for a share of the general overhead of the organization or for depreciation.

The Association objects to both. The option suggested would not achieve parity with business (which are permitted to allocate expenses between activities on an actual basis) but instead would unfairly penalize exempt organizations which attempt to limit their costs by permitting external access to expensive equipment or facilities.

TAX INFORMATION REPORTING/INTERNAL REVENUE SERVICE (IRS) ADMINISTRATION

The Association firmly believes that changes to the unrelated business income tax should be based on hard information rather than anecdotes of abuse. Accordingly, the Association supports the Subcommittee's discussion options which expand the current reporting requirements imposed upon tax-exempt organizations. We urge the Subcommittee to use this data and information to carefully examine the impact that any change in the UBIT law may have on the administrative impact on hospitals. The Association supports the proposal to recommend that the Internal Revenue Service study nonprofit exempt hospital reorganizations (examining the purpose, effect of the use of subsidiaries), and the use, purpose, and effect of joint ventures. Only after these comprehensive studies are complete should the Congress proceed to consider making changes in the UBIT law.

CONCLUSION

The Association supports the current application of the UBIT law and pertinent regulations which allow necessary flexibility in responding to the crisis of change in which hospitals find themselves. In order to remain fiscally sound and in a position to deliver services to the community and provide charity care, hospitals must be able to engage in revenue-producing activities that are competitive and within fair, defined limits.

It would be detrimental to the delivery of high quality health care services to drastically change the rules governing the operations of tax-exempt enterprises, on which 85% of the nation's hospitals rely. Any change in tax policy that would decrease the ability of these hospitals to engage in appropriate revenue-raising activities would undermine the competitive model of health care and the promise of continued high quality services.

The Association believes that the current legislative, regulatory, and judicial treatment of UBIT as applied to not-for-profit health care facilities is appropriate; it is understandable, it is predictable, and it is workable.

In light of the current lack of complete data and other necessary information on the methods and types of activities that relate to this issue, as well as the nature and extent of the allegations of unfair competition that have been made, the Association urges that any action regarding unrelated business income tax provisions await the completion of the Internal Revenue Service audit now underway, and the completion of the suggested studies and additional data collection activities recommended in the Subcommittee's discussion options.

STATEMENT OF

ALDRICH, EASTMAN & WALTCH,

THE BOSTON COMPANY,

COPLEY REAL ESTATE ADVISORS &

PROPERTY CAPITAL ASSOCIATES

On March 31, 1988, the Subcommittee on Oversight of the Ways and Means Committee requested comments on the preliminary discussion options relating to the unrelated business income tax ("UBIT") presented to the Subcommittee. We are pleased to have the opportunity to respond to this request, and in particular to the discussion options relating to investments in real property and the receipt of loan commitment fees.

INTRODUCTION

Before providing our specific comments, an introduction is appropriate. We are four real estate investment management firms based in Boston. We advise major taxable and tax-exempt investors and manage their real estate investments.

Our clients are long-term investors who view real estate as an integral part of a prudently diversified investment portfolio. Many of our clients are pension funds, which represent the largest single source of long-term equity capital for the real estate industry. Real estate historically has provided them with stable current returns and opportunities for appreciation in value. We have been responsible for acquiring, directly and indirectly, several billion dollars in office buildings, retail and industrial projects, and multi-family residential properties, on behalf of our clients as portfolio investments. Frequently, these investments in real property take the form of joint ventures involving both tax-exempt partners and taxable partners (who are typically developers or property management firms). Joint ventures offer pension fund and other tax-exempt investors the opportunity to gain from the expertise of professional real estate firms, who typically will make investment opportunities available only if they are able to participate in the transaction. Additionally, many of these investments are partially financed with third party debt, thereby increasing the potential investment return for the owners of the property. Some of the projects are developmental or rehabilitation projects, while most are acquisitions of existing property.

1. Development of The Discussion Options

Last summer, the Subcommittee held hearings on the administration of the UBIT provisions of the Code. The hearings focused on the issue of whether tax-exempt organizations are competing unfairly against small taxable businesses. The record of the hearings is virtually devoid of any discussion of investment in real estate by tax-exempt entities, largely because tax-exempt entities do not, as a practical matter, have any competitive advantage as investors in commercial real estate. Nevertheless, the discussion options set forth in Paragraph VI of the Subcommittee's press release contain two proposals that would constitute major changes in the UBIT treatment of real estate investments by tax-exempt entities. These proposals -- imposing a 20 percent equity requirement and a new pass-through entity rule -- would generally have the effect of reducing investment returns for tax-exempt investors and, therefore, would make it more difficult for domestic pension funds and other tax-exempts to compete for investment opportunities against other investors, particularly foreign investors. For several reasons, these proposals should not be adopted.

First, pension funds and other tax-exempt organizations that invest in real estate have not yet recovered from the stream of changes in section 514(c)(9) that have been enacted or proposed in every year since 1984, some of which have been given retroactive effect. Section 514(c)(9) initially was added to the Code in 1980. It was then amended in 1984, amended again in 1986, and then amended once again in 1987. Additional changes to the statute have already been proposed in the recently introduced Technical Corrections Bill of 1988 (H.R. 4333). Some of these amendments were intended to correct errors, or perceived errors, in previously enacted amendments. One result of this series of amendments is that little or no investment in joint ventures with leveraged real property by tax-exempt organizations has occurred since October 13, 1987, because it is virtually impossible in any actual transaction to satisfy either the qualified allocation or disproportionate allocation tests of the 1987 amendment to the statute. Further, many transactions that had been planned over a long period could not proceed to completion because of the 1987 amendment. Most importantly, it has been impossible to plan or negotiate new investment transactions because of fears about additional changes in the law. Thus, the cumulative effect of these changes has been a de facto, unintended repeal of the UBIT exception for debt-financed real estate by joint ventures, despite the fact that Congress continues to support the ability of pension funds and endowments to engage in such transactions without incurring UBIT.

The impact of these recent changes to section 514(c)(9) can be illustrated by the following typical transaction. A group of pension funds and college endowments invest as limited partners to develop, build, lease and hold an office building with a taxable developer. The tax-exempt organizations contribute most or all of the capital while the developer may make a small capital contribution and will manage the construction and operation of the property. A nonrecourse loan is obtained for the balance of the acquisition price, although during construction the developer might be required to guarantee the loan. The tax-exempt partners are entitled to priority distributions of a fixed rate of their invested capital (or, perhaps, of their excess capital), and 80 percent of the remaining profits; the remaining 20 percent of the profits flow to the developer. After the investor partners have recouped their capital, the developer is entitled to one-half of the profits. In a perfect world, the tax allocations would follow the cash distributions -- with cumulative income allocated to the tax-exempt entities to the extent of their cumulative preferred distributions and thereafter in accordance with their share of the excess distributions of profits. Losses would be allocated in accordance with the partners' share of profits (in excess of priority distributions), subject to the restrictions on losses contained in the section 704(b) substantial economic effect regulations.

This transaction would not have caused the pension fund to have unrelated business income ("UBI") between the enactment of the 1980 legislation and October 13, 1987, although this result would not have been evident between the effective date of the 1984 legislation and the enactment of the 1986 legislation (because the technical correction was retroactive). The endowment would not have had UBI between the enactment of the 1986 legislation and October 13, 1987. However, despite the fact that this transaction is not tax motivated, it does not satisfy either the qualified allocation test or the new disproportionate allocation test of section 514(c)(9)(E). In fact, even if the profit sharing ratio was 50-50 at all times, the tests could not be satisfied. As evidence that these transactions are not tax motivated, you should note that the same investment structure is used when all or some of the partners contributing the capital are taxable.

Second, based on the absence of any discussion of real estate investments during the 1987 hearings, there is no basis for raising these issues at this time. In this regard, the 1987 hearings focused on the competition issues — in particular, the disadvantages that businesses face in trying to compete with tax-exempt colleges and foundations. Ironically, the competition issue also affects real estate investments, but in exactly the opposite way. Because of the tax law changes referred to above, pension funds, endowments and other tax-exempt investors are now at a severe disadvantage in competing with foreign investors for quality real estate investments.

Third, the discussion options are too vague to be understood and have no apparent underlying policy except to undercut the ability of pension funds, endowments, foundations and charities to invest in real estate.

2. The Discussion Options Conflict With Other Policies

These obstacles blocking tax-exempt investment in real estate will have a significant adverse economic impact on tax-exempt organizations and should, therefore, be important to the Subcommittee. Over the last several years, too much effort has been concentrated on narrow, highly theoretical and often specified tax abuse concerns, while broader national economic policy concerns have been ignored. For example, real estate provides an optimal long-term, income-producing investment for pension funds, which, in turn, are essential vehicles for the retirement income security of millions of Americans. Congress is continually faced with concerns with respect to whether today's workers will be able to retire with a secure source of adequate retirement income. In one respect, Congress dealt with this issue in a comprehensive manner in 1974 with the enactment of ERISA provisions compelling pension fund asset managers to make prudent investments to meet the retirement needs of beneficiaries and to diversify pension fund portfolios. Yet, recent amendments to UBIT provisions such as section 514(c)(9) severely undermine this policy objective by reducing the availability of attractive, secure, income-producing investments.

Similarly, education has become a great national concern. The cost of a college education has escalated beyond the means of most Americans, while federally funded subsidies and guaranteed loans for higher education have been slashed. In order to educate our next generation of teachers, scientists, leaders and scholars, the cost of education must be met by means other than tuition and subsidies. Yet, by unduly restricting the ability of college endowments to invest in attractive, income-producing real estate opportunities, their ability to find alternative means to help defray the costs of education are reduced. The same problem exists for foundations and public charities seeking to pick up the slack as the federal government has reduced social welfare programs over the past decade. By denying these organizations the opportunity to compete with foreign investors who own real estate in the United States, their ability to obtain the returns necessary to meet society's social welfare obligations is hampered.

Accordingly, we urge the Subcommittee or full Committee to keep in mind the desired policy underlying the debt-financed real property UBIT exception contained in section 514(c)(9) and determine (i) whether the current statute advances that policy, and (ii) whether the proposed options (as well as the proposed technical corrections to section 501(c)(25), and possible technical corrections to last year's amendments to section 514(c)(9)) will serve or interfere with that policy.

HISTORY OF THE DEBT-FINANCED INCOME RULES AND THE REAL PROPERTY EXCEPTION

1. 1950 Act

We turn now to the policy underlying both the UBIT and debt-financed property statutes in general, and the real property exception in particular. The best place to start is with the enactment of the original UBIT statute in 1950. Like the current study by the Oversight Subcommittee, the original UBIT statute was triggered by and directed primarily at the problem of unfair competition to for-profit corporations and the resulting revenue loss to Treasury. H. Rep. No. 2319, 81st Cong., 2d Sess 27 (1950). Congress wanted the business of charity to be charity, supplemented by passive earnings on its capital funds. The original UBIT statute was in response to the extension of the "destination of the income" test by the courts. E.g., Roche's Beach, Inc. v. Commissioner, 96 F.2d 776 (2d Cir. 1938). As originally enacted, the UBIT provisions applied only to certain exempt organizations. State colleges and universities were subjected to UBIT in 1951, qualified plans in 1954, and most other exempt entities in 1969.

Excluded from the definition of UBI in the 1950 statute and at all times thereafter were the traditional forms of passive investment income earned by exempt organizations, such as dividends, interest, royalties, gains and losses from the sale of property (except stock in trade, property held for sale to customers or timber cut by the organization), and rents. Not all rents, however, were excluded from the definition of UBI in 1950. Due to concerns relating to the unfair competitive advantage that tax-exempt purchaser-lessors might have in sale-leaseback transactions, Congress characterized as UBI net income from debt-financed property leased for more than 5 years. While the impetus for the statute was sale-leaseback transactions, it applied regardless of whether the seller and lessee were related. The 1950 statute was designed to tax only the income derived from and allocable to the debt-financing. Income allocable to the capital invested by the exempt organization was not considered UBI. Accordingly, the amount of net income constituting UBI was limited to the ratio of the debt-financing to adjusted basis. Minor changes were made to this provision in 1954.

2. Tax Reform Act of 1969

In response to Commissioner v. Clay B. Brown, 380 U.S. 563 (1965), and similar abusive transactions, the UBIT provisions were amended after careful study in 1969. Some of the amendments expanded the scope of section 514 by extending the debt-financed property rules to unrelated income from all debt-financed property, and not merely to rental income from real property. Other changes made in 1969 involved the use of average basis and acquisition debt figures for computing the ratio of income from debt-financed property that would be characterized as UBI, limiting depreciation to straight line, and other changes limiting expenses that could reduce UBI.

3. 1980 Act

By 1980, Congress recognized that the 1969 amendments to section 514 represented overkill in certain circumstances. In particular, the restrictions on debt-financed income were inappropriate when applied to prudent, debt-financed real estate investments by qualified retirement trusts. Unlike other exempt organizations, the purpose of the exemption for the investment income of such trusts was to enable them to accumulate funds, which eventually would be used to pay employee benefits, taxable to the recipients at ordinary rates. Real estate investment enabled the trustees to diversify their investment portfolios and historically provided a hedge against inflation.

In light of these considerations, as well as the fact that real estate acquisitions were commonly debt-financed, Congress enacted, as section 514(c)(9) of the 1954 Code, a narrow real property exception from the definition of "acquisition indebtedness." This exception generally excluded debt incurred by a qualified trust as a result of the acquisition or improvement of real property. Pub. L. 96-605, § 110(a), 94 Stat. 3525. As originally enacted, this section specified five situations when the real property exception would not apply. These situations encompassed areas in which Congress had concerns regarding abuses under pre-1950 and pre-1969 law that had caused it to previously tax all debt-financed income.

4. 1984 Act

In the Deficit Reduction Act of 1984, Congress reexamined the 1980 exception for certain debt-financed real property by extending the qualified plan exception of section 514(c)(9) to real property held by certain educational institutions (as defined in section 170(b)(1)(A)(ii)) and certain affiliated support groups. Pub. L. 98-369, § 1034(a), 98 Stat. 1039. The price for expanding the class of tax-exempt entities qualifying for the debt-financed property exception was to impose new restrictions applicable to partnerships including exempt and taxable organizations (including organizations with UBIT). Section 514(c)(9)(B)(vi). At that time, Congress indicated that it was concerned with the potential ability of pension trusts (and other exempt entities) to shift tax benefits, such as unused ACRS deductions on debt-financed property, to taxable entities. Under the 1984 amendment, an organization that was a partner in a partnership holding real property could qualify for the section 514(c)(9) exception to the debt-financed property rules only if either (1) all of the partners were organizations qualifying for the exception, or (2) each allocation to a qualified organization was a qualified allocation. For purposes of these rules, if the pension trust or educational organization had any other UBI, it would not be treated as an organization qualifying for the section 514(c)(9) exception unless the partnership had qualified allocations.

An allocation constituted a qualified allocation under these rules if it met the partnership allocation rules under the tax-exempt entity leasing provisions of section 168(j)(9). These allocation rules required (1) that the qualified organization be allocated the same percentage share of each item of partnership income, gain, loss, deduction, credit and basis (excluding allocations attributable to contributed property), (2) this share remain the same during the entire term of the partnership, and (3) that the allocation have substantial economic effect under the section 704(b) partnership regulations. Similar rules applied in the case of any pass-through entity other than a partnership and in the case of tiered partnerships. Treasury was granted broad authority to promulgate regulations necessary or appropriate to carry out the purpose of these provisions.

While at first glance the 1984 Act was thought to broaden the real property exception, its practical effect was devastating to many common, non-abusive debt-financed transactions. A substantial portion of such investments involve joint ventures because the taxable partners are in the business of real estate develolpment and management, whereas pension funds and endowments are passive investors, and not active developers or managers of real estate. Most pension funds do not have the personnel or expertise to engage in such activities. In addition, joint ventures assist the tax-exempt investor in prudently diversifying its portfolio. Thus, joint ventures arrangements are an essential part of real property investment by tax-exempt organizations.

The qualified allocation test presented (and still presents) a number of obstacles. First, it does not permit preferred returns to the tax-exempt investor, who typically contributes most of the capital to the transaction, and even the level of permitted guaranteed payments to a tax-exempt investor is unclear. Second, it does not permit a tax-exempt investor to have limited liability without incurring or the risk of incurring UBIT. Third, it does not take into account differing capital contributions by the partners without imposing deficit restoration obligations on those partners with disproportionately small contributions. In the rare situation that a developer (which normally has the small contribution) is willing and able to undertake a deficit restoration, the impact is to accelerate deductions to the taxable partner from the tax-exempt entity; this result is hardly to the benefit of the Treasury. Fourth, qualified allocations do not clearly permit incentives to a managing general partner because such incentives may constitute a shift in the allocations. As a result of these problems, leveraged investment in most real property by most qualified organizations largely came to a halt.

5. 1986 Act

Scarcely had the ink dried on the 1984 amendments to section 514(c)(9) before Congress amended it again. In 1986, section 514(c)(9)(B)(vi) was changed again in two subtle but important ways. First, the requirement that allocations be qualified allocations was liberalized to a "principal purpose of tax avoidance" test. The test was changed because transactions involving qualified organizations (qualified plans and educational endowments) and other persons or entities could not be done under the 1984 qualified allocation standard. This noncontroversial change occurred in a technical amendment. Had the conference report described the scope of this provision and set forth situations in which a tax avoidance motive would be presumed, no further amendments of the statute would have been necessary.

The second 1986 change involved the addition of section 501(c)(25) collective investment entities to the Code and their inclusion as qualified organizations eligible for the real property exceptions of section 514(c)(9). By investing through a section 501(c)(25) entity, a foundation or charity could receive the benefits of the real property exception it could not enjoy had it invested directly in the property. (Section 116 of H.R. 4333, the Technical Corrections Bill of 1988, would eliminate this benefit retroactively).

An equally significant change made by the 1986 Act has been totally ignored in discussions of section 514(c)(9) since 1986, to wit, the radical reduction in the value of tax benefits pursuant to that legislation. The institution of the passive loss rules, the extension of the at-risk rules to real estate, the requirement of capitalization of construction period interest, and the reduction in rates, combined with the fact that in most cases the property will have to be depreciated over a 40-year useful life, makes the tax benefits available in these cases of relatively small value. Moreover, because of the passive loss rules, these benefits are only of use to certain corporations and those developers who happen to have substantial cash flow from other investments.

6. 1987 Act

Early in 1987, however, some tax writers became concerned that the 1986 amendment to section 514(c)(9) went too far. No abusive transactions otherwise permitted under prior law were presented to justify this belief. In fact, the purported abusive examples that were mentioned could not have passed muster under section 704(b)(2) and the 1986 version of section 514(c)(9)(B)(vi). Nevertheless, the restoration of the qualified allocation standard was included on the 1987 list of revenue options considered by the Ways and Means Committee. Interestingly, such a provision was initially projected to raise $400 million over a 3-year period, while the prior year's technical amendment (that it reversed) lost no revenue. H.R. 3545, as passed by the House, would have restored the qualified allocation standard. Although the Senate bill contained no similar provision, the conference agreement reinstated the qualified allocation standard and added the alternative disproportionate allocation test of section 514(c)(9)(E). Unfortunately, this hastily drafted conference agreement is internally inconsistent and effectively constitutes the de facto repeal of section 514(c)(9) for debt-financed joint ventures. The Treasury Department, taxpayers and tax-exempt investors are all dissatisfied with the current statute.

7. Technical Corrections Act of 1988

Section 204(g) of the H.R. 4333, which would amend section 514(c)(9)(E) to give Treasury additional regulatory authority to resolve conflicts between the statutory tests, is insufficient to make the statute workable. For example, section 514(c)(9), in its current form, causes qualified organizations that are limited partners to have UBI unless they agree to unlimited liability. Yet, pension funds prefer to invest as limited partners precisely to limit their exposure to such risks. In fact, some trustees may interpret their fiduciary obligations as prohibiting them from undertaking such risks. Thus, prudent, passive investing designed to protect a pension fund's corpus would be subject to UBIT whereas a fund that placed all of its funds at risk would not. No sound tax policy can justify such a result.

Even with the proposed 1988 technical amendment and assuming prompt issuance of regulations, many perfectly straightforward transactions will still not qualify for section 514(c)(9) treatment. For example, if a taxable investor and a tax-exempt investor each provide $500 of capital for a partnership in which a managing general partner is allocated 20% of the profits until a specific event occurs and 40% of the profits thereafter, the tax-exempt partner will not be entitled to the benefits of section

514(c)(9). There seems no reason whatsoever why the tax-exempt investor should not be entitled to the benefits of section 514(c)(9) under these circumstances.

POLICY CONSIDERATIONS

1. Need for Certainty

In short, tax-exempt investors are frustrated by this constant changing of the statute. For sound domestic economic policy reasons, Congress has taken the position that pension funds and endowments may make leveraged investments in income producing real property without incurring UBIT; this decision should not be undermined by placing undue restrictions on such investments, particularly where those restrictions are based on vague and unsubstantiated reports of theoretically possible abuses. In addition, section 514(c)(9) must be restored to a workable format for debt-financed joint venture investments.

Pension trusts and other tax-exempt organizations are long term investors who expect certainty of tax structure in making their investments. Negotiations for these investments occur over many months and the actual investments at times are made over several years. Changes in the law can dramatically change the expected investment yield from an investment. Moreover, the theoretical opportunity for abuses cannot justify the additional time and expense needed to monitor and comply with these constant changes in the law.

2. The Hearings Do Not Justify These Discussion Options

Given these concerns over an already constantly changing statute, the Subcommittee's discussion options for unrelated debt-financed income are puzzling. Virtually all of the other discussion options are based on issues and concerns raised during the hearings last summer. The real property exception to unrelated debt-financed income, however, was not substantively discussed at the hearings. Moreover, the policy underlying the real property exception, to the best of our knowledge, has not been called into question. Unlike a number of other business activities, no one has complained that qualified organizations are somehow trading on their exemption to outbid taxable persons for real property and/or tenants. If anything, the market for real property has been skewed by foreigners investing in the United States and accepting lower rates of return than domestic investors. Tax-exempt investors are at a disadvantage in competing for quality real estate investments due to the shackles placed on them by the tax code; taxable developers and managers may become reluctant to negotiate with pension funds or endowments due to the fear that they will need to restructure an agreement to meet annual changes in the tax law.

No arguments have appeared on the public record indicating why the discussion options constitute sounder tax policy than current law. Tax-exempt organizations are not trading on their tax-exemptions. Leveraged investment in real property continues to be part of a sound national economic policy for pension funds and endowments. If anything, these proposals undercut the broad Congressional policy regarding retirement income security, the affordability of higher education, and the social welfare of the less fortunate in our society.

3. The 20 Percent Equity Test Makes No Sense

No policy rationale has been articulated for this 20 percent equity test. The 20 percent test seems to be imported from residential real estate, whereas lenders for commercial property use debt service coverage ratios. In short, we believe that this proposed restriction is unnecessary. It is not a problem in the market; lenders will not provide funds if the security is insufficient and developers and other investors do not give tax-exempt organizations "free rides" in their properties. The 20 percent rule reinstates the general debt-financed income ratio test, with an arbitrary additional requirement that a ratio above 80 percent debt-financed income causes all of the income to be UBI. Congress has rejected the regular "ratio test" in the context of qualified organizations investing in real property. It is logically inconsistent to impose a stricter test in its place while maintaining that the policy for the original exception remains unchanged.

The 20 percent test will not impact the vast majority of investments by qualified organizations. However, the problem with injecting the 20 percent equity standard into the Code is that every investment must then be policed to avoid the loss of section

514(c)(9)'s benefits. Policing this additional standard would reduce yields and burden society with additional non-productive costs.

Moreover, the proposed 20 percent threshold equity test is incomprehensible in its present form. For example, what is the base on which the required investment is calculated and what will constitute an investment for this purpose? Must the tax-exempt organization invest cash or is a partially or fully recourse obligation sufficient? Does the 20 percent relate to initial purchase price or fair market value? How do improvements to the property affect the base against which the 20 percent is measured? Do cash flow distributions and depreciation reduce the investment in the property so that the tax-exempt investor will eventually become taxable? If a loan is refinanced, does the 20 percent test continue to apply and, if so, 20 percent of what? Our inquiries indicate that these issues have not been considered by the Subcommittee. Leaving these issues to be resolved by regulations is of no value to taxpayers until regulations are issued, a process that can take years.

4. The Pass-Through Provision is Unneeded

Paragraph VI of the discussion options also states that the character of debt-financed income received from all pass-through entities by a pension fund or endowment should be retained. This provision is totally unnecessary and undesirable.

On its face, this provision is unclear. We have been informed, however, that this new proposal to retain the character of debt-financed income received from all pass-through entities is intended to apply primarily to income from REITs, RICs, and REMICs. This proposal should be eliminated because it would reclassify these entities from carefully regulated partial conduits into pure conduits without taking into account the entire system that has been developed for taxing distributions from these entities.

For example, in determining the character of distributions from a REIT, Congress decided not to look through the REIT to see how it earned its income. Congress has already established an elaborate set of rules to govern how a REIT may earn its income, including the kind of investments it can make. Once these tests are satisfied, however, the income and distributions are all taxed in the same manner. Thus, dividends from a REIT are uniformly treated as portfolio income for purposes of the passive loss rules. If a pass-through approach were to be used, most of the income would be passive under section 469 and could be used to offset losses from any tax shelters. Distributions from a REIT are currently excluded from UBIT because an investment in a REIT does not differ in any material way from investments in shares of stock in a corporation. Similarly, an investment in a REIT by a RIC is treated as stock or securities for purposes of the kinds of income a RIC may receive. It is the same type of passive-type income generally excluded from UBI under Section 512.

If you look through a REIT for purposes of examining whether it has debt-financed income, you are really treating the REIT like a partnership for some purposes but not others. The character of a REIT should not be trifurcated for purposes of the treatments of losses, passive versus portfolio income, and taxable versus tax-exempt partners.

In short, this radical change would produce myriad technical problems which neither we, our advisors, nor the authors of this proposal have begun to consider. It should not, therefore, be put forward until its consequences can be reasonably understood.

For example, assume that a pension trust invests in two REIT's, one of which produces taxable income and the other of which produces losses. Will the pension trust be able to offset the losses in one REIT against the profits in another? How can it be sure that it will be able to obtain the information it will need to comply with the Code if the REIT's management takes the perfectly reasonable position that it is unwilling to burden its other investors with the costs of supplying this information?

5. The Rent Based Upon Net Income Test

We agree with the substance of the proposal that would exempt from UBI contingent rental income received from a prime tenant attributable to fixed rents paid by a subtenant. In general, rents that could have been received tax-free from a lessee should not become taxable when received indirectly from sublessees through a lessee. Obviously, this exception should apply to rents received from a prime tenant attributable to rents received from a subtenant whose rent is based upon a percentage of gross receipts or sales. Since the exempt organization itself could receive rents of the types being paid by such subtenants and itself pay the expenses of operating the property, there would seem to be little reason to prevent an exempt organization from indirectly receiving a portion of the same net income from the operation of the property.

We would make one further recommendation. There seems to be no reason why the statute applicable to exempt organizations should not contain a provision paralleling section 856(d)(4) which would subject exempt organizations to UBIT only on that portion of any contingent rent received from a tenant attributable to rents paid by a subtenant dependent upon its net earnings. The principal purpose of such a provision would be to avoid accidental disqualification of the entire rent from a property where a tenant mistakenly enters into a sublease which calls for contingent rent paid on net income. At the same time, this protects Treasury by subjecting the portion attributable to such payments to UBIT.

6. Commitment Fees

We also agree with the proposal that exempts from UBIT investment income earned from non-refundable loan commitment fees. This is a good rule that complies with the statutory policy because commitment fees are a normal component of lending money and are consistent with fees charged by a passive lender. The lender is simply being compensated for evaluating the loan and for committing funds that could otherwise be invested elsewhere.

CONCLUSION

We commend the Subcommittee for engaging its study of the UBIT. It makes sense every 15-20 years for Congress to step back and take a fresh look at how well an area of the Internal Revenue Code is working and whether its underlying policy is still sound and is being implemented. Unfortunately, over the past four years, Congress has amended section 514(c)(9) many times without this careful reflection. This has wreaked havoc with the tax-exempt entities qualified to use the section, as well as their potential partners. Our group would certainly support the Subcommittee in a serious and thoughtful study of the tax on unrelated business taxable income as it applies to real estate investments. However, the proposals made in the March 31 press release seem to us the result of mere tinkering rather than of any comprehensive review of the subject matter.

No evidence has been developed that the types of purported abuses at which the 1984 and 1987 amendments and the current proposals are aimed are widespread or even significant, when compared with the total amount of real estate investments made by tax-exempt organizations. We therefore urge the Subcommittee not to pursue any of the proposals in the press release (other than those ameliorative proposals described under the heading "Miscellaneous") and defer legislation on this subject until a thoughtful and thorough study of the problems in this area and the manner in which funds are being invested in real estate by tax-exempt organizations can be carried out. In the interim, what is needed is a correction of section 514(c)(9) in its current form so that it fulfills the Congressional purposes of permitting pension funds, endowments, and collective investment entities to make leveraged real property investments, while preventing the improper shifting of losses or income between the taxable and tax-exempt sectors.

Allen Taylor Pharmacy and Hearing Aid Center
Sycamore and E Street
Elizabethton, Tennessee 37643
April 12, 1988

The Honorable J. J. Pickle, Chairman
House Ways and Means Oversight Subcommittee
1105 Longworth House Office Building
Washington, D. C. 20515

Dear Sir:

We, the hearing aid dispensers in Tennessee are very concerned about commercial hearing aid sales by non-profit organizations throughout the state. There are several of these organizations in Tennessee, namely, East Tennessee State University Speech and Hearing Center, Kingsport Speech and Hearing Center, Bristol Speech and Hearing Center, University of Tennessee Speech and Hearing Center, Bill Wilkerson Speech and Hearing Center, Tennessee School for the Deaf, Memphis School University Speech and Hearing Center and Mountain Region Speech and Hearing Center. Many of these non-profit organizations work through senior citizens centers thereby causing us to lose potential clients.

The House Ways and Means Oversight Subcommittee has proposed an excellent package of reform measures, and we urge your committee to include all these measures in its final report. We also ask that the subcommittee apply UBIT to all hearing aid sales income of non-profits and to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

Hearing aid dispensers throughout the state of Tennessee appreciate everything the House Ways and Means Oversight Subcommittee has done, and I personally wish to thank you for all of your efforts.

Sincerely yours,

Samuel D. McQueen
Samuel G. McQueen
Certified Hearing Aid Audiologist

Copies to:
Robert J. Leonard
John J. Duncan
Richard D. Jones
Richard L. Clark
Tom Moyer
Cliff Shaw

Allen Taylor Hearing Aid Center
Sycamore and E Street
Elizabethton, Tennessee 37643

The Honorable J. J. Pickle, Chairman
House Ways and Means Subcommittee
1105 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Pickle:

I am writing to thank you and this committee for the package of reform measures that you proposed, and to respectfully ask that all of the measures you proposed be included in the final reports.

Dispensers in Tennessee are aware of commercial hearing aid sales by non-profit organizations and are disturbed because of the effects they are having on our business. We lose many potential clients because of unfair competition from these organizations. I also would like to urge that UBIT be applied to all hearing aid sales income of non-profit organizations and that the "convenience" exemption for patients be repealed.

Thank you for your consideration.

Sincerely,

Robert White

Robert White
Certified Hearing Aid Audiologist

Copies to:
Robert J. Leonard
John J. Duncan
Richard D. Jones
Richard L. Clark
Tom Moyer
Cliff Shaw

A M A D O R
Amador Corporation Wild Mountain Road Taylors Falls, MN 55084-0270 612 583 3322

April 14, 1988

Robert J Leonard
Chief Counsel
Committee on Ways and Means
US House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Reference: Press Release # 16 on UBIT

Dear Mr Leonard

As one who testified at the June hearings specifically in opposition to public safety organizations, viz., Underwriters Laboratories (UL), right to operate as a 501 (c) (3) organization, I was deeply disturbed to note that the discussion option in the press release # 16 to "Modify rules applicable to organizations 'testing for public safety'" might include merely creating a new exempt category outside of 501 (c) (3).

Amador Corporation is a small Electromagnetic Compatibility (EMC) testing laboratory, grossing about 1% in revenues compared to UL. Yet we were willing to take the time to travel to Washington to prepare testimony and appear before the Committee for questioning. The Record speaks for itself. UL did not choose to testify. Perhaps they would have received the same response from the Members as the Colleges and Universities who were criticized for their "testimony." UL was in the audience, but instead of appearing, they received my written testimony from my hand the day of the Hearings and began their lobbying.

UL is a formidable foe in this area. On my trip to Washington to follow up with the Committee Staffers of the Pickle Subcommittee, I was told about the many visits of UL's Washington-based lobbyist, Mr Bhatia, the visits of Mr Bono, their President and the lobbying of Mr Haugh, their Chairman of the Board. I understand they are now even including the nation's fire chiefs in their efforts. The connection of Electromagnetic Compatibility performance testing to fires is a distant one, but UL continues to expand their services and is now involved in EMC.

I was also asked by these Staffers what sort of compromise Amador would be interested in. This prompted my call to

Mr Bono to discuss compromise. I told him that I, as a member of the honorable opposition, would be willing to look at some compromise. Mr Bono gave me no particular encouragement about this matter, so I followed up with Mr Haugh with a personal letter and telephone calls. Mr Haugh did not return my calls. Compromise is apparently not a consideration for UL.

In our phone conversation, Mr Bono outlined that he has been talking directly to the Members and telling the Congressmen that their pricing is competitive. I was told by an employee of UL after identifying myself and my organization that UL charges $ 1250 for the first day of testing and $ 975 for the second day. Amador charges $ 2500 for each first shift, twice what Mr Bono charges for the first day and 250% more for the second day! When I told Mr Bono this information, he was momentarily speechless. He tried to claim that there must be some difference in the service offered. Yes, we believe the quality of testing and the dedication of the Amador employee is superior, but the first time customer often does not know this. Many people buy on price, even in the compliance testing business. And UL's price is one half or less than that of Amador's.

Mr Bono has spent the equivalent amount of money (less the amount not required by non-profits for sales taxes and interest) for his new electromagnetic compatibility testing facility as that also paid by Amador. For your reference I have enclosed a copy of the publicity given out by the architect on the building. Although the UL equipment is virtually identical, they paid 6% less for it then I did. I would like to pose the question on how UL can afford to sell a service at an average cost of $ 1000 + per day and be able to recover the investment made in capital equipment and advertising, etc. If you would like further detailed figures, Amador would be happy to provide a list of typical costs for such an endeavor.

Further, in my same conversation with Mr Bono, he stated that, to-date, UL has apparently restrained itself from entering certain fields, but that if they lost their tax exempt status it could be expected that they would be in a mode of entry into other (testing) businesses. From my perspective, I have noted they are already entering any business they choose on the pretext of "safety." We request only that UL pay taxes and let us compete fairly.

Companies who misuse the UL symbol are often fined as much as $ 100,000 by UL. And no taxes are paid on that "revenue."

UL has many benefits from their tax-exempt status. My accountants have advised me that I could raise my personal income four fold under such an exempt arrangement!
There are literally thousands of labs who would be crazy to

There are literally thousands of labs who would be crazy to not take advantage of this loophole. After our presentation of the facts, Amador would provide ample evidence to the IRS that a tax-exempt status is apparently suitable and fitting for Amador and many other labs.

There has even been some discussion about a "class action" on the part of for profit whereby the legal fees would be greatly reduced.

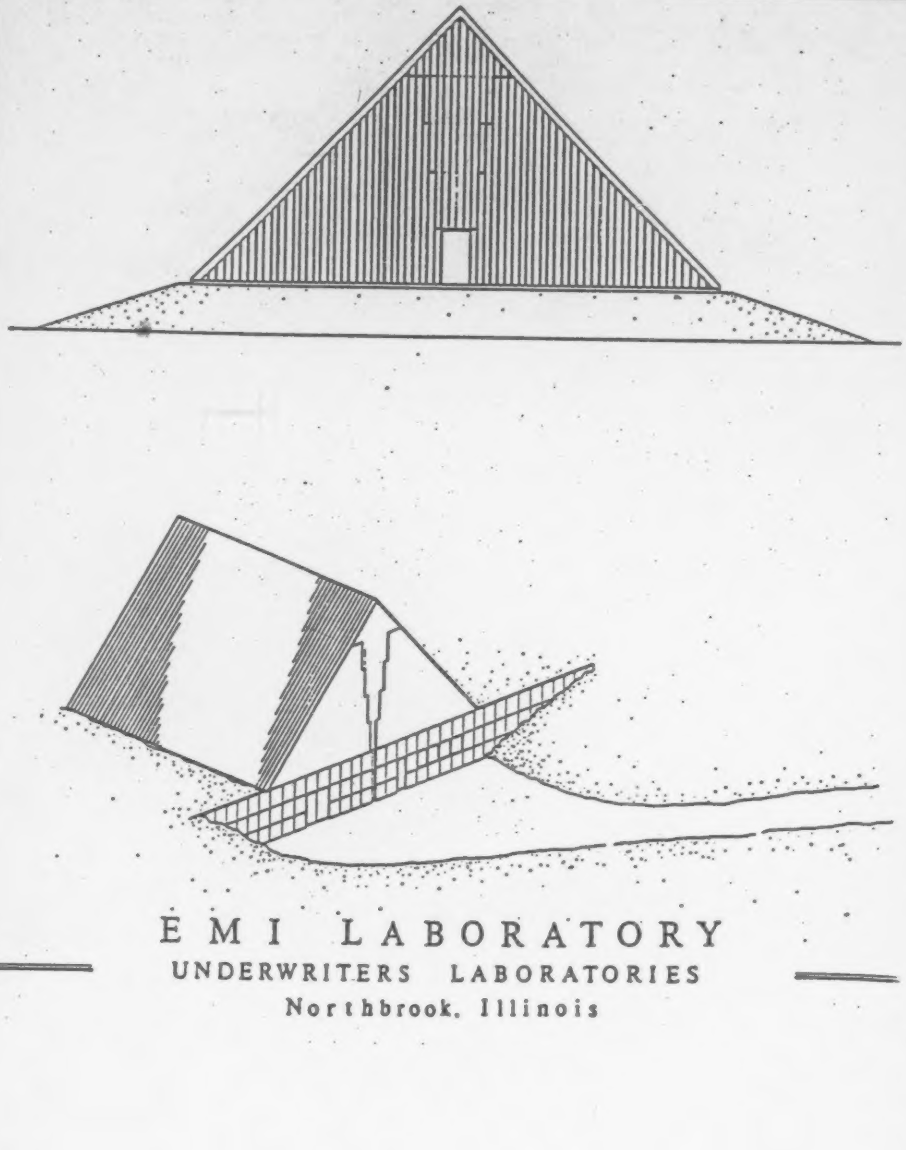
If the UL exemption is upheld, I, and a number of my colleagues who own labs will have to consider joining the ranks of the tax exempts. For the Committee to merely "modify" the rules versus remove the exemption will be a clear signal to the labs and their tax lawyers of the US to become tax exempt.

Is this what the Committee wants? Please let the record speak for the fact that all labs, including public safety labs, shall be taxed.

Sincerely

James Wm Johnson
Associate & Chief Executive Officer

c Dan Hoolihan



EMI LABORATORY
UNDERWRITERS LABORATORIES
Northbrook, Illinois

ELECTROMAGNETIC INTERFERENCE LABORATORY
UNDERWRITERS LABORATORIES, INC.

Cost: $1,000,000
Completion: 1987

Site: Northbrook, Illinois
Size: 9,500 Square Feet

This two story facility was designed for the measurement of electromagnetic interference produced by electronic devices. The F.C.C. requires that laboratories for E.M.I. testing be constructed of materials which do not reflect the radio frequency waves emitted by the device being tested. To accommodate these requirements, a superstructure and enclosure of the upper level testing area were designed to be constructed entirely of fiberglass reinforced plastic components.

The testing procedure consists of placing a device on a turntable, which is recessed in a grounded metal plane on the upper level floor, and measuring the radio frequency waves which are produced. Testing is controlled from a laboratory on the lower level, since the presence of people in the test area would interfere with results. Additional laboratories are also located on the lower level, along with offices, support facilities and an equipment lift.

Since the building is located in a flood plain, the upper level is elevated above grade and the lower level entrances are protected by a system of earth berms and retaining walls. The site topography and plantings are designed to blend with the features of the adjacent landscaped cooling ponds and natural prairie preserve.

American Analytical Laboratories

April 11, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways & Means
US House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

Please be advised that I am strongly opposed to any changes in the Unrelated Business Income Tax (UBIT) laws that the committee is now proposing.

We are a small business giving employment to more than 13 individuals, most of whom are women and/or minority group members. We provide laboratory testing services in the environmental area to other small businesses, small cities and municipalities, manufacturers, several Bureau of Land Management jurisdictions, and Native American Indian Tribes. We are just one of about 15 privately held environmental laboratories in Arizona.

A major competitor of AAL is the non-profit Analytical Services Center at the University of Arizona. Too, a large local non-profit hospital has recently opened its clinical microbiology laboratory for commercial testing of drinking water samples. Competition by non-profit corporations is an increasingly serious problem to small businesses in Arizona. I urge the Subcommittee not to change any of the regulations which would make it easier for government agencies and other non-profit organizations to compete against American Free Enterprise.

Sincerely Yours,

Athol L. Cline, Ph.D.
President & CEO

CC: Rep. Kolbe
Rep. McCain

3441 East Milber St. Tucson, AZ 85714
Phoenix 602-866-3110
Tucson 602-889-5787
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AAHA
AMERICAN ANIMAL HOSPITAL ASSOCIATION
an association of animal hospitals and small animal practitioners
DENVER WEST OFFICE PARK • P.O. BOX 150899 • DENVER, CO 80215-0899
PHONE: 303/279-2500

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
US House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

The American Animal Hospital Association represents over 10,000 veterinarians who deliver veterinary medical services to pet animals. As such we are vitally concerned with the issues addressed by the Subcommittee on Oversight, Committee on Ways and Means, regarding Unrelated Business Income Tax.

Chairman Pickle, Representative Schulze, and the entire subcommittee should be commended for an excellent package of reform measures, as reported in press release #16 of March 31, 1988. Unfair competition is a serious problem, and the entire business community, including veterinarians, is depending on the subcommittee to recommend substantial reform to the full committee.

While the measures proposed are appropriate in many cases, I would like to express concern over item I.F. relating to veterinary services. As currently written, this statement would exclude all veterinary services from UBIT unless they are purely cosmetic. Boarding, grooming, and sale of pet products are not considered veterinary services. To exclude "measures recommended by a veterinarian for the health of the animal" effectively excludes all veterinary services provided by tax-exempt organizations from UBIT. This, then, creates unfair competition for the thousands of tax-paying private practitioners.

M.L. WILLEN, DVM
President
222 Wagon Wheel Drive — Palm Desert, CA 92260

In order to prevent unfair competition, the American Animal Hospital Association recommends that item I.F. be reworded as follows:

F. Apply UBIT to income from all veterinary services, with the exception of the following:

  * veterinary services performed on stray animals or animals owned by indigent people;

  * veterinary services performed by teaching institutions in order to provide clinical education for veterinary medical students and technicians; and

  * spaying and neutering, when performed prior to adoption of a pet from a shelter or agency.

Like all veterinarians, we are concerned with the delivery of high quality veterinary care to the pet animal species of this country. We also are committed to meeting the needs of the public as they relate to pets. However, veterinarians cannot provide services needed if we must compete with tax-exempt organizations. We urge adoption of fair UBIT rules and request that the rewording as suggested above be adopted and forwarded to the full committee.

Thank you for the opportunity to respond.

Sincerely,

Milton L Willen

Milton L. Willen, DVM
President

mje

cc: AAHA Board of Directors

American Arts Alliance

COMMENTS OF THE AMERICAN ARTS ALLIANCE
ON DISCUSSION OPTIONS
RELATING TO THE UNRELATED BUSINESS INCOME TAX
TO THE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE

APRIL 15, 1988

Comments Submitted by
Anne G. Murphy, Executive Director

The American Arts Alliance, a consortium of over 300 nonprofit performing and exhibiting arts institutions, welcomes this opportunity to respond to the Unrelated Business Income Tax (UBIT) discussion options outlined in the Oversight Subcommittee's March 31, 1988 press release. While we recognize the Subcommittee's interest in this area, we are concerned that a number of the discussion options hold out, perhaps inadvertently, troublesome and threatening implications for nonprofit arts organizations.

"Substantially Related" Test

Before addressing specific concerns, we would like to discuss the overall changes being suggested in the definition of UBIT and its application. We can accept the Subcommittee's desire to ensure that the philosophy underlying current UBIT law is adhered to, i.e., that nonprofit organizations clearly distinguish between those activities that are related to their mission and those that are not, and that they pay UBIT on income from unrelated activities. Arts institutions, according to a 1986 American Arts Alliance survey, have a high rate of compliance with the UBIT law and support efforts to see that it is adhered to.

In our view, the "substantially related" test is the proper standard in the tax-exempt organizations context and should be retained. Over the years, an enormous amount of law and precedent has evolved to amplify the "substantially related" standard. We see no need for the elimination of this valuable precedential law, which would occur if a "directly related" test were to be substituted for the "substantially related" test.

Overall, the "substantially related" test has worked well and there is no need to replace it. Moreover, a move to the "directly related" test would not minimize the role of the Internal Revenue Service (IRS); under either test, the IRS would have to exercise judgment, on a continuing basis, as to whether an activity is "related" or "unrelated".

Also, we urge rejection of an approach in which each income-producing activity of an exempt organization would be evaluated, as to qualification for tax exemption, "standing alone." As the long-standing "operational test" indicates, an activity usually can only be evaluated as to eligibility for tax exemption in the context of the exempt purpose of the organization. The "standing alone" concept might force many beneficial activities to be classified as unrelated activities. This would occur because the activity would be evaluated in isolation, without understanding of the exempt organization context in which it was developed and is being operated.

Thus, while we do not endorse all of the proposed classifications, listed in the press release, of the "specified activities" as unrelated ones, we do believe that, if changes must be made in this field, it is best if the particular problem areas be identified and addressed. This approach would be far preferable to a wholesale revision of the unrelated income rules.

"Inherently Commercial" Standard

We are very concerned about the prospects of the proposal identified as I. L. in the press release, which is to "Apply UBIT to additional specified activities determined to be inherently commercial." We oppose any attempt to vest in the Internal Revenue Service administrative authority to make determinations as to whether a particular activity is "inherently commercial."

Not only are we unable to ascertain who is to make this determination, but in addition, we are concerned with implementation of general standards based upon an "inherently commercial" doctrine. We oppose a move toward any such standard and hope this reference is not intended to place in the Internal Revenue Code (IRC) a general "catch-all" provision respecting "inherently commercial" activities.

In sum, we object strongly to departure from a substantiality test that a) is based on strong moral and pragmatic reasoning and b) has served the nonprofit arts community -- and the public audiences it serves -- well.

The option list proposes to deviate from the relatedness standard that has served as the linchpin of the UBIT since its inception in 1950. We are concerned that this not only raises the prospect for replacement of the current "substantially related" test with a "directly related" standard, but also, in some instances, on a number of issues, ignores the relatedness standard altogether.

Gift Shops Sales

Nowhere is this departure from the relatedness standard more evident than in the area of gift shop sales. On the proposal to eliminate UBIT exemptions for gift shop items other than low-cost mementoes and items directly related to the organization itself, we have a number of concerns.

First, we are pleased that the Subcommittee recommends continuing an exemption from UBIT for low-cost mementoes. Sales of tee-shirts, mugs and posters bearing the logo of a theater, dance or opera company, museum, or orchestra help create not only public awareness of the institution's existence and purpose, but enhance public interest in the arts in general.

Similarly, we appreciate the reference to retention of the exemption for on-premise sales of related items. We believe this is in keeping with the rationale on which the UBIT is based and will allow nonprofit institutions to continue their sales of materials that deepen audience enjoyment of the event. A tape of Beethoven's Fifth Symphony allows the symphony-goer to take home a part of his evening's experience in the same manner that facsimiles of original art works help prolong the museum visitor's awareness, appreciation, and understanding of the objects he has seen.

Where we have deep concern, however, is with the suggestion that the definition of relatedness may be based on a requirement that items relate directly to the "educational nature" of the "organization visited". We fear such a change may draw lines so tightly as to restrict the tax-exempt educational mission of nonprofit, particularly arts, institutions.

A vital part of a nonprofit arts group's tax-exempt mission is to educate the public, and gift shop sales are in general intrinsically linked to the effort to deliver educational services. Providing a wide range of materials, including many that are broader in scope than an institution's particular collection, on the background and interpretation of an art work at hand is fundamental to that activity.

For instance, a book on the general history of art can be as important to understanding a particular art exhibit as a catalog focused on the exhibit itself. Similarly, a discussion of the development of opera can shed as much light on a given evening's production as the more specific libretto. In just the same way, for a symphony orchestra to sell recordings by other orchestras of works it performs is vital; for a museum to sell reproductions of works reflective and/or illustrative of its collection -- but not necessarily in the collection -- is equally vital. In both instances, the background materials essential to understanding the particular production may be broader in focus than the organization itself, but to consider them unrelated to the organization would be a mistake.

The ability of these materials to shed fuller light on the organization's programs connects them directly to the organization's purpose. Small institutions in particular, whose scope and reach is necessarily limited by space and budget limitations, depend on these kinds of educational materials to provide the background required for audiences to fully understand a given performance or exhibit.

We recommend that language defining the relatedness standard apply to the organization's mission, not just the nature of the organization visited. We also request language in the report accompanying the recommendations make it clear that a related function of arts organizations is the sale of arts-related items.

Off-Premise Sales

Regarding the Subcommittee's other option suggesting that off-premises sales of items be subject to the UBIT, we again have concerns.

Ticket Sales

Although we do not believe the Subcommittee intends to include mail and phone order ticket sales in the category of off-premise sales that would be taxed, a literal interpretation of the option could imply exactly that. In light of the fact that ticket sales are the lifeblood of nonprofit arts groups, and the ability to meet customer demand through mail and phone sales is critical to broadening sales to the fullest extent, we strongly oppose any suggestion to tax income from mail and phone-order tickets. Arts institutions would be forced to raise ticket prices, making their productions accessible to an ever smaller portion of the public at precisely the same time they are being encouraged by the federal government to broaden access.

Catalog Sales and Satellite Shops

Catalog sales and satellite shops are other areas affected by the Subcommittee's off-premise option. These sales broaden an institution's educational impact as well as its outreach efforts. They work to educate long-standing patrons at the same time that they introduce new segments of the public to the institution.

Our nation's cultural institutions have shown time and again that a major educational component of an exhibition or production is the catalog, program, or other informational material that accompanies it. When read leisurely on one's own, these materials convey a thorough and long-lasting understanding and appreciation of the art seen.

Publication Sales

Another area potentially affected by the off-premise sales option is the development, publication, and sale of discipline-related books and other publications that some arts service organizations have as a central part of their mission. Sales of these materials, with which commercial publishers will not get involved and which therefore do not compete with commercial book sales, are a way to meet the educational needs of the field. Income they produce goes to cover the costs of publication, and, if possible, to meet expenses of the service organization's other educational programs.

Because of their small size and narrow audiences, these nonprofit service organizations rely on mail announcement of new publications to generate sales. Were the Subcommittee's off-premise suggestion to be accepted, the ability of many nonprofit arts service organizations to keep their fields informed of trends and developments would be hurt.

Taken together, the Subcommittee's proposals to tax off-premise sales and to narrow UBIT exemptions for on-premise sales would undermine the ability of nonprofit institutions to broaden public awareness of their existence and to bring a sense of their programs and educational functions to people who are not regular visitors. In short, arts institutions rely on sales of related items to reach out to new and more diverse audiences. Mail order, catalog, and satellite shop sales are vital to that effort.

We urge that no change be made in the current standard of relatedness governing application and interpretation of UBIT in the context of sales of items by arts organizations.

Advertising Income
A Subcommittee option proposes taxation of all net advertising income. This proposal would be harmful to arts organizations because of the paid advertising that is contained in theater programs and similar publications. These programs are not sold, but provided without charge to the patrons of performing arts events. The revenue generated by the sale of tickets does not cover the costs of producing the performance program -- that is the function of the advertising. (Ticket sales, in fact, cover less than 50 percent of the cost of a performance.) These kinds of programs are an essential tool of the trade and their expense is an unavoidable cost.

Another area that the new allocation proposal for advertising income would affect is publications and newsletters which institutions use to inform and educate their audiences about activities and current trends in the field. If nonprofit arts groups are allowed to deduct only the direct costs of advertising, rather than the costs of the entire publication, from advertising income, their ability to continue offering publications will be limited.

Consequently, we urge no change in the federal tax treatment of advertising revenue received by tax-exempt organizations [IRC Sec. 513(c)]. However, if the Subcommittee continues to believe that general changes in this area are required, we request an exception from the new approach for revenue from advertising in publications that are distributed without charge to tax-exempt organizations' constituencies, such as programs for performing arts events.

Royalty Income
We urge that the recommendations from the Subcommittee not include the entirety of the proposed changes in the tax law definition of the term "royalty" [IRC Sec. 512(b)(2)]. That is, we believe that it is unfair to tax true royalty income where the property being used was created by the tax-exempt organization, or where the organization performed substantial services or incurred substantial costs with respect to the development of the property.

Generally, a royalty is a form of income representing consideration for the use of the property. A royalty may arise in the context of a licensing agreement. Usually, the royalty amount is indefinite in that it is dependent upon the production or sales of the licensee or other person that is obligated to pay the royalty.

In many, if not most, instances, the royalty income is passive income to the recipient of the royalty. That is why, when the recipient of a royalty is a tax-exempt organization, and the income is passive in nature, the income is excluded from taxation under the "modification" rule of IRC Sec. 512 (b)(2).

In most instances, a royalty is paid to a person that created or developed the property, such as an author of a book or the writer of music. Where the property is thereafter placed in the hands of another for further development, such as marketing, the income paid to the originator of the property, determined on the basis of sales volume, is a classic passive-income royalty payment.

Examples of this exist in the world of theater. Theaters have a number of possible ways to handle royalties on productions originating under their auspices. The most common of these is an arrangement whereby the playwright agrees to give the theater a small percentage of the royalties he receives. The theater then applies those monies to the costs involved in funding the development of new works. In these arrangements, the originating theater has no further involvement in the development of marketing of the production, whether done by a nonprofit or commercial theater.

Similarly, an opera company uses recordings and videos of its critically-acclaimed productions to make them available to as broad an audience as possible. Royalties from these works are used to recoup part of the enormous financial investment involved in bringing the new work to the stage. Frequently, these items are sold commercially, in "off-premise" sales. Since the opera company has no involvement in the subsequent marketing or selling of the recording and videos, the royalties they generate are passive income.

Likewise, museums often derive revenue, as royalty income, from the licensing of the right to reproduce and sell items from their collections. This is another example of passive income that should not be taxed.

We do not understand why a tax-exempt organization, that creates a property or performs substantial services or incurs substantial costs with respect to the initial development of a property and thereafter turns that property over to another, and that has no involvement in the further development or marketing of the property, may not receive that type of passive income without taxation. We hope that royalties on tapes and videos of symphonies, ballets, and operas would not be rendered taxable if shown on commercial television or distributed through commercial enterprises. Such videos and other similar materials help extend the work of art to a far greater range of audiences than live performance alone would permit.

We know that the unrelated income rules were enacted to tax net income from unrelated businesses that are actively conducted, so as to prevent unfair competition. However, passive income is not derived in a way that involves unfair competition.

We agree that income generated for the benefit of a tax-exempt organization, where the exempt organization is actively involved in the income-producing process, should be taxable (unless, of course, the income-producing activity is related to the exempt purposes of the organization). Thus, for example, where the relationship between the parties is one of a non-exempt joint venture, the income should be taxable, irrespective of whether it is denominated a "royalty." (Indeed, it is our understanding that this is the present state of the law.) Therefore, we have no objection to a statutory clarification of the law, making it clear that, when a tax-exempt organization is actively involved in the marketing of a property, its resulting compensation is not a tax-free "royalty."

However, we strongly recommend that taxable income to a tax-exempt organization not include passive royalty income, encompassing situations where the exempt organization created the property or had a substantial involvement in the initial development of the property.

Mail List Exchanges and Rentals
We note that the press release calls for consideration of "modifications of various piecemeal UBIT exclusions enacted since 1969."

We urge that the present law exempting from taxation the rentals and exchanges of mailing lists [IRC Sec. 513 (h)] not be disturbed. Exchange and rental between nonprofit arts institutions is, for the most part, the only option such groups have to target the arts consumer. If arts institutions had the manpower and computer capacity to retain and regularly update lists of hundreds of thousands of names, reliance on exchanges and rentals would not be so crucial. But few arts institutions have such an advantage, and therefore a combination of resources through sharing of lists is the only option available.

We submit that the existing law on the point represents a fair and workable compromise of the relevant policy considerations.

Regularly-Carried On Test
We strongly recommend that the "regularly carried on" test be retained. We believe that the fund-raising functions that occur only infrequently (such as benefit performances and other special events) at arts and other nonprofit institutions would be treated by this proposal as taxable businesses.

We suspect that the thinking behind the proposal is that the "regularly carried on" test is superfluous, redundant, or otherwise unnecessary, in that the types of activities of concern to us are not "businesses." However, under present law, the term "trade or business" includes any activity which is carried on for the production of income from the "sale of goods or the performance of services" [IRC Sec. 513(c)]. This definition is sufficiently sweeping as to embrace many special event fund-raising activities.

These events are not inherently commercial nor are they competitive with taxable enterprises. We submit that there is no compelling tax policy reason for treating fund-raising events of this type as taxable businesses.

Consequently, we recommend that the "regularly carried on" test be retained. If this cannot be done, we recommend that the definition of the term "trade or business" be amplified to make it clear that occasional fund-raising events are not "businesses" for federal tax purposes.

Allocation of Rental Expenses
We object to the proposal to not allow, when computing unrelated business taxable income, a deduction for the allocable share of the general overhead of the organization or for a share of the appropriate component of the depreciation.

In the instance of a dual-use facility, we believe that it is only fair to allow a tax-exempt organization to allocate overhead and depreciation, on an appropriate basis, to the unrelated use. Taxable businesses are allowed to utilize overhead and depreciation when computing their taxable income. This type of allocation is the essence of the functional method of accounting, which the IRS has required of tax-exempt organizations for years.

We urge instead that the law be clarified to state the method for allocating overhead and depreciation to the unrelated use.

Many arts institutions incur enormous costs in maintaining the buildings in which they operate. Rental of their facilities has been an important element in helping defray ongoing costs of operations.

Travel and Tour Programs

The Subcommittee's option proposing to eliminate the UBIT exemption for travel and tour-service income raises other considerations. Specialized travel programs are used primarily to meet expectations of an institution's members, develop new supporters, cultivate future contributors, and provide an "extra touch" to regular member services. To be taxed on the minimal amount of income such programs raise would force many institutions to drop travel services entirely, letting the benefits they bring to members fall by the way.

Travel programs, offered by only a small number of performing and exhibiting institutions, are for the most part operated through commercial entities. While an arts group may develop the idea of a travel program, in general it leaves the actual organization of the trip to a commercial travel agent.

Therefore, we urge that the UBIT not be applied to travel and tour programs that are related to a nonprofit arts institution's mission and are offered to members and patrons.

Food Sales/Other Convenience Activities

We are pleased that the Subcommittee recognizes the important role food services play in enhancing enjoyment of a visit to the institution. We hope the Subcommittee will not limit the opportunity of institutions to provide such a convenient service to their visitors by limiting food service sales to the immediate confines of the institution's building. The ability to make eating arrangements readily available throughout the entire vicinity/premises of the institution allows groups and individuals the opportunity to extend their stay as long as possible.

While the list of options is silent on income from other services provided for the convenience of visitors, such as parking lots and coat rooms, we trust and assume that the rationale underlying the Subcommittee's decision on food sales will apply to these areas. Parking and coat-room facilities are as essential as food sales to the ability to comfortably visit a performing or exhibiting arts institution.

Deduction from Taxable UBIT

We are similarly pleased with the proposal to raise the UBIT deduction for certain tax-exempt organizations from $1,000 and we support the $10,000 figure that is mentioned as a new cap.

Additional Reporting Requirements

We understand the need for additional information on the scope and extent of nonprofit institutions' income-producing activities. While increased reporting will undoubtedly impose added burdens on many nonprofit groups, we agree with Subcommittee findings that it is important to efforts to legislate and govern wisely in this area.

Conclusion

These comments have set out our priorities in the area of income-producing activity in relation to the Subcommittee's option paper and should provide an idea of what our needs are. We hope that the Subcommittee, in further action, will not apply UBIT in such ways as to restrict the ability of nonprofit arts institutions to undertake those activities that help carry on their service to the public.

Nonprofit arts institutions are granted tax-exempt status because they serve the national welfare. Unlike commercial endeavors, they are not held hostage to shareholders who demand a return on their investment. Rather, arts institutions seek only artistic excellence, provided such excellence is passed along to the nation's citizens. But that responsibility is becoming increasingly difficult to shoulder.

Rising operating costs and the slowdown in federal funding for nonprofit arts institutions must be offset by additional earned and contributed income. Yet these sources of support are now endangered by tax policy changes. The only alternative solutions to mounting financial pressures -- raising admission prices and reducing outreach services -- are contrary to the very purposes for which nonprofit arts institutions are established. When the arts are no longer readily accessible to the public, when they reach only those who can afford them, the arts will belong not to the public but to the marketplace.

Public policy has long recognized that the substantial contributions made by nonprofit organizations to American life should not be subject solely to the demands of the market. To ensure that such institutions have the financial resources they require to carry out their tax-exempt purposes, the federal tax code has traditionally protected nonprofit earnings and through charitable deductions, encouraged private contributions.

These enlightened federal tax policies have served this country well. They have enabled the construction of the three-tiered financial foundation of private-sector contributions, direct government funding (usually requiring a match of private monies), and earned income, that supports the arts in America. This structure has provided invaluable social benefits to the American people, who are now beginning to reap a rich artistic harvest. The system that finances the American arts has also provided economic benefits to government, relieving the public treasury of burdens it would otherwise have to bear.

Due to recent changes in federal tax and spending policies, rising costs at nonprofit arts institutions, and stagnant federal funding, this is no time to make any further changes in policies that have stimulated the growth of the arts in America. If anything, Congress should take steps to shore up the three tiers that support the arts. But the national interest will certainly not be served by the enactment of proposals limiting the ability of nonprofit arts groups to be self-sustaining and to generate much-needed income through activities related to their exempt purpose.

We request the opportunity to testify at the Subcommittee's hearing to be held following the comment period.

American Arts Alliance

MEMBER INSTITUTIONS

A Contemporary Theatre
The Acting Company
Actors Theatre of Louisville
Akron Art Museum
Akron Symphony Orchestra
Alabama Shakespeare Festival
Alabama Symphony Orchestra
Alaska Repertory Theatre
Albany Symphony Orchestra
Albright-Knox Art Gallery
Allen Memorial Art Museum
Allentown Art Museum
Alley Theatre
Alliance Theatre Company
Alvin Ailey Dance Theater
AMAS Repertory Theatre
American Ballet Theatre
American Conservatory Theatre
American Repertory Theatre
Amon Carter Museum of Western Art
Anchorage Civic Opera
Arena Stage
Arizona Opera Company
Arizona Theatre Company
Arkansas Arts Center
Arkansas Opera Theatre
Arkansas Symphony Orchestra
Art Institute of Chicago
Artpark
Asian Art Museum of San Francisco
Asolo State Theater
Atlanta Symphony Orchestra
Augusta Opera
The Baltimore Museum of Art
Baltimore Opera Company
Baltimore Symphony Orchestra
Barter Theatre
Bella Lewitzky Dance Company
Berkeley Repertory Theatre
Boise Philharmonic
The Boston Ballet
Boston Symphony Orchestra
Bowdoin College Museum of Art
Brandywine River Museum
Brooklyn Musuem
Buffalo Bill Historical Center
Buffalo Philharmonic Orchestra
Cabrillo Music Festival
Canton Symphony Orchestra
Capital Repertory Company
Carnegie Institute Museum of Art
Center Stage
Center Theatre Group of Los Angeles-Mark Taper Forum
Charlotte Symphony Orchestra
Chautauqua Opera Company
Chicago Opera Theater
Chicago Symphony Orchestra
The Children's Theatre Company
Cincinnati Opera Company
Cincinnati Playhouse in the Park
Cincinnati Symphony Orchestra
Cincinnati/New Orleans City Ballet
Circle Repertory Company
The Cleveland Museum of Art
Cleveland Opera
The Cleveland Orchestra
Cleveland Play House
Colorado Opera Festival
Colorado Springs Fine Arts Center
Colorado Springs Symphony Orchestra
Columbus Museum of Art
Columbus Symphony Orchestra
Connecticut Grand Opera
Connecticut Opera
Contemporary Arts Center, Cincinnati
Contemporary Arts Museum of Houston
Corcoran Gallery of Art
The Corning Museum of Glass
Cummer Gallery of Art
Cunningham Dance Foundation
Dallas Ballet
Dallas Museum of Art
The Dallas Opera
Dallas Symphony
Dallas Theater Center
Dance Center of Columbia College
Davenport Museum of Art
Dayton Art Institute
Dayton Opera
Dayton Philharmonic Orchestra
Denver Center Theatre Company
Denver Symphony Orchestra
Des Moines Art Center
The Detroit Institute of Arts
Detroit Symphony Orchestra
El Paso Pro-Musica
Elvehjem Museum of Art
The Empty Space Theater
Erie Philharmonic Orchestra
Evansville Philharmonic Orchestra
Fargo-Moorhead Civic Opera
The Feld Ballet
Fine Arts Museums of San Francisco
Flint Institute of Arts
The Flint Institute of Music
Florentine Opera of Milwaukee
The Florida Orchestra
Fort Wayne Philharmonic
The Fort Worth Art Museum
Fort Worth Opera Association
Fort Worth Symphony Orchestra
Four Corners Opera
George Street Playhouse
Georgia Museum of Art
The J. Paul Getty Museum
GeVa Theatre
Glimmerglass Opera Theatre
Gold Coast Opera
Goodman Theatre
Goodspeed Opera House
Grand Rapids Symphony
Grant Park Symphony Orchestra
Great Lakes Theater Festival
Greater Miami Opera Association
The Solomon R. Guggenheim Museum
Guthrie Theater
Harry's Foundation
Hartford Ballet
Hartford Stage Company
Hartford Symphony Orchestra
The Hartman Regional Theatre
Harvard University Art Museums
High Museum of Art
Honolulu Academy of Arts
Honolulu Symphony
Honolulu Theatre for Youth
Houston Grand Opera
Museum of Fine Arts, Houston
Houston Symphony Orchestra
Huntington Theatre Company
Indiana Repertory Theatre
Indiana University Art Museum
Institute of Contemporary Art, University of Pennsylvania
Intiman Theatre Company
University of Iowa Museum of Art
Jacksonville Symphony Orchestra
Japan Society Gallery
Herbert F. Johnson Museum of Art
Joslyn Art Museum
Kalamazoo Symphony Orchestra
University of Kentucky Art Museum
Kentucky Opera
Kimbell Art Museum
Lake George Opera Festival
Laura Dean Dancers and Musicians
Lexington Philharmonic Orchestra
Long Wharf Theatre
Los Angeles County Museum of Art
Los Angeles Master Chorale
Los Angeles Philharmonic
Los Angeles Theatre Center
Los Angeles Theatre Works
Murray Louis Dance Company
Louisville Ballet
The Louisville Orchestra
Lubbock Symphony Orchestra
Lyric Opera of Chicago
Lyric Opera of Kansas City
McCarter Theatre
Marion Koogler McNay Art Museum
Madison Art Center
Madison Opera
Manhattan Punch Line Theatre
Manhattan Theatre Club
Margaret Jenkins Dance Company
Memorial Art Gallery, University of Rochester
Memphis Brooks Museum of Art
Memphis Symphony Orchestra
Mendelssohn Choir of Pittsburgh
Metropolitan Museum of Art
Metropolitan Opera
Michigan Opera Theatre
Milwaukee Art Museum
Milwaukee Ballet
Milwaukee Repertory Theatre
Milwaukee Symphony Orchestra
Minneapolis Institute of Arts
The Minnesota Opera
Minnesota Orchestra
Mississippi Opera Association
Missouri Repertory Theatre
Mobile Opera
Montgomery Museum of Fine Arts
The Pierpont Morgan Library
Museum of Modern Art
Nashville Symphony Orchestra
Nelson-Atkins Museum of Art
Neuberger Museum, State University of New York at Purchase
Nevada Opera Association
New Dramatists
New Federal Theatre
New Mexico Symphony Orchestra
New Orleans Opera Association
New York City Ballet
New York City Opera
New York Philharmonic Orchestra
New York Shakespeare Festival
The Newark Museum
Nikolais Dance Theatre
Northeastern Pennsylvania Philharmonic
Northlight Theatre
Norton Gallery and School of Art
Oberlin Dance Collective/San Francisco
Old Globe Theatre
Omaha Magic Theatre
Opera Carolina
Opera Columbus
Opera Delaware
Opera Memphis
Opera Omaha
Opera Theatre of Saint Louis

Oregon Shakespearean Festival
Oregon Symphony Orchestra
Pacific Northwest Ballet
Paul Taylor Dance Company
Pennsylvania Academy of the Fine Arts
Pennsylvania Stage Company
Philadelphia Drama Guild
Philadelphia Museum of Art
The Philadelphia Orchestra
Philharmonic Orchestra of Florida
Piedmont Opera Theatre
Pittsburgh Opera
Pittsburgh Public Theater
Pittsburgh Symphony Orchestra
Playmakers Repertory Company
Playwrights' Center
Playwrights' Horizons
Portland Art Museum, Oregon
Portland Museum of Art, Maine
Portland Opera Association, Oregon
Portland Stage Company, Maine
Portland Symphony Orchestra, Maine
The Art Museum, Princeton University
Queens Symphony Orchestra
Repertorio Español
The Repertory Theatre of Saint Louis
Rhode Island Philharmonic
Rhode Island School of Design, Museum of Art
Ririe-Woodbury Dance Company
Rochester Philharmonic Orchestra
Rockford Symphony Orchestra
Sacramento Symphony
Saint Louis Art Museum
Saint Louis Symphony Orchestra
San Antonio Symphony
San Diego Opera Association
San Diego Symphony
San Francisco Ballet
San Francisco Museum of Modern Art
San Francisco Opera
San Francisco Symphony Orchestra
San Jose Repertory Company
Santa Barbara Museum of Art
Santa Barbara Symphony Orchestra
Santa Fe Opera
Sarasota Opera Association
Seattle Art Museum
Seattle Children's Theatre
Seattle Opera Association
Seattle Repertory Theatre
Seattle Symphony Orchestra
Shakespeare Theatre at the Folger Library
Shreveport Opera
Shreveport Symphony
Skylight Comic Opera
Smith College Museum of Art
South Bend Symphony Orchestra
South Coast Repertory
Southeastern Center for Contemporary Art
Southern Illinois University Museum and Art Gallery
Spoleto Festival, USA
StageWest
Stanford University Art Museum
Syracuse Opera
Syracuse Stage
Syracuse Symphony Orchestra
Tacoma Art Museum
Telfair Academy of Arts and Sciences
Texas Opera Theater
Theater for the New City
Theatreworks/USA
The Toledo Museum of Art
Toledo Symphony Orchestra
Tri-Cities Opera Company
Trinity Repertory Theatre
Trisha Brown Company
Tulsa Opera
Tucson Symphony Orchestra
Twyla Tharp Dance Foundation
Utah Museum of Fine Arts
Utah Opera Company
Utah Symphony Orchestra
Vermont Symphony Orchestra
Virginia Museum of Fine Arts
Virginia Opera Association
The Virginia Symphony
Wadsworth Atheneum
Walker Art Center
The Walters Art Gallery
The Washington Ballet
The Washington Opera
Whitewater Opera Company
Wichita Art Museum
Williamstown Theatre Festival
Winston-Salem Symphony
Winterthur Museum
Wisdom Bridge Theater
Wolf Trap Foundation
Yale Center for British Art
Yale Repertory Theatre
Yale University Art Gallery

ASSOCIATE MEMBERS

American Federation of Musicians
American Music Center
Poets and Writers
Teachers and Writers Collaborative

April 15, 1988

Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth Building
Washington, D.C. 20515

Dear Rep. Pickle:

The American Association for State and Local History represents more than 10,000 historical organizations throughout the United States -- all of whom would be severely affected by the proposed revision by your subcommittee of the "substantially related" test of unrelated business income for non-profit organizations. In that most historical organizations and museums have been in the past chartered as 501(c)3 corporations, their ability to care for America's historic patrimony will be impaired if they are now required to pay taxes on their hard won earned income. As a consequence we hereby urge your reconsideration of various facets of the proposal.

Specifically we are opposed to the taxation of much of the income outlined in your press release of March 31 due to the fact that historical organizations have had to struggle endlessly to find new funds to care for growing collections of historical objects and to provide programs to make them available through exhibits and other public purposes. With a diminishing level of public funds and charitable donations available to us, we have turned to earned income sources as a means of filling the difference between resources and needs. In doing so we have reduced our demands for evergrowing amounts of public revenues.

The various areas identified for taxation in the future by your subcommittee directly attack those realms where we have discovered and developed these alternate sources of support. Almost all historical organizations produce catalogues for the sale of their educational publications as a basic means of carrying out their mission. Historical organizations make use of tours and tour programs as a basic means of teaching American history. Food sales and certain product sales provide essential visitor services and information to visitors to our historic sites and museums. Advertising income has been used as a means of offsetting the expense of producing educational magazines and newsletters essential to the educational, curatorial, and cultural purposes of our organizations.

AMERICAN ASSOCIATION FOR STATE AND LOCAL HISTORY
172 Second Avenue, North, Suite 102, Nashville, Tennessee 37201
Telephone: (615) 255-2971

We have cooperated with other organizations in developing even more detailed comment on the proposed revisions including especially the American Association of Museums. We commend to you the detailed analyses provided to you by our sister institutions.

We urge, however, a reconsideration of the impact of those proposed changes on historical organizations. While your subcommittee may be trying to correct practices used by some large non-profit organizations, historical organizations are generally wholly volunteer groups that are barely able to comply with current tax laws. Your proposed changes would only exacerbate an already complicated situation.

Our organization will be happy to discuss these concerns further with you and committee staff. We appreciate your concern for the work and proposes of America's abundant small historical organizations.

Sincerely,

Larry E. Tise
Director

Statement of American Association for the Advancement of Science Concerning Options Relating to the Unrelated Business Income Tax

The undersigned are submitting comments to the Options Relating to the Unrelated Business Income Tax ("UBIT") issued as Press Release #16 by the Ways and Means Subcommittee on Oversight on March 31, 1988. These comments are submitted on behalf of American Association for the Advancement of Science ("AAAS").

AAAS, which was organized in 1848, is a Section 501(c)(3) scientific and educational organization. As indicated by its name, AAAS's objectives are to further the work of scientists, to facilitate cooperation among them, to improve the effectiveness of science in the promotion of human welfare, and to increase public understanding and appreciation of the importance and promise of the methods of science in human progress.

One of AAAS's most important scientific and educational activities is the publication of a weekly journal entitled Science. Thomas A. Edison began publishing Science in 1880, and Alexander Graham Bell was one of its successor publishers. Since 1900, Science has been the official publication of AAAS. Its technically oriented articles are usually written by scholars and scientists, which have included over 140 Nobel Prize winners. Science is a unique source of technical scientific information, and AAAS has strived to make Science a clearinghouse where scientific discoveries and research are presented and discussed.

AAAS has numerous other scientific and educational programs. For example, in the face of a mounting nationwide crisis in science and mathematics education, AAAS has undertaken a variety of projects aimed at improving the quality of high school science and mathematics education for all Americans. AAAS also holds meetings, colloquia and seminars dealing with issues affecting science, the technology of science and the public understanding of science and technology.

As a primary observation, we do not believe that the Subcommittee on Oversight should repeal the "substantially related" test as the vehicle for determining UBIT. For the past thirty-five years, this workable test has been developed and refined by a significant body of IRS administrative precedents, and to a lesser extent, by judicial precedents. The "substantially related" test provides detailed legal guidance to both exempt organizations and the Internal Revenue Service with respect to the business activities of exempt organizations which should be subject to UBIT. Its repeal would be tantamount to throwing away a significant body of developed law in favor of a new test, such as the proposed (but as yet undefined) "directly related" test, which would require the interpretative process to commence anew at a significant cost both to exempt organizations and to the Internal Revenue Service. Because we believe that a total overhaul of UBIT provisions is clearly not warranted, we favor the Subcommittee's second option of analyzing specific commercial activities of exempt organizations if the Subcommittee determines that changes may be necessary.

With respect to advertising activities referred to in Paragraph I. J. of the Subcommittee's Release, the Supreme Court recently addressed the this issue and concluded that advertising contained in journals published by exempt organizations was subject to UBIT.

U.S. v. American College of Physicians, 475 U.S. 834 (1987) . The practical application of the Court's holding in that case results in the application of the UBIT to almost all advertising in exempt organization journals. In light of the Court's recent decision, we question whether it is now necessary for the Subcommittee to address the advertising income area as part of its deliberative process.

We do, however, take exception to the view that allowable deductions against advertising income be limited to direct advertising costs and, hence, exclude costs attributable to the readership content of an exempt organization's journal. The Section 512 regulations create a reasonable test in allocating readership costs as an allowable deduction against advertising income. There is no question that a journal would have no advertising income if it did not produce editorial content of interest to the reader. Disallowing the current deductibility of excess readership costs would be patently unfair to exempt organizations and would be an unrealistic fragmentation of the advertising activity of a journal from its substantive content. Moreover, we believe that this action would place exempt organizations at a *disadvantage* with for-profit publishers.

We have the same view concerning the Allocation Rules contained in Paragraph VIII of the Release. No for-profit business we know of is precluded from deducting, as a legitimate cost of its business, general overhead expenses and depreciation against its business income. We believe that the Allocation Rules also represent an unrealistic fragmentation of exempt and unrelated business activities and would serve to place exempt organizations at a *disadvantage* when compared to for-profit businesses engaging in the same activity. We certainly do not understand the spirit of the Subcommittee's current analysis of the UBIT area to be the implementation of rules giving a competitive advantage to for-profit businesses.

As indicated in the Subcommittee's Release, the UBIT is a "sensitive area" of the tax law, and there are "very strong and appropriate" concerns of both tax-exempt organizations and the for-profit business community in insuring that the UBIT works correctly and as intended by Congress. The UBIT has been logically and consistently developed and refined for over thirty-five years. It represents a legitimate, very workable and fair balancing test for exempt organizations and for-profit businesses. We certainly hope that the Subcommittee does not now take a short-term view in enacting changes to the UBIT which have been hastily considered or which are not supported by sufficient facts and empirical analysis. We also hope that the Subcommittee's work on the UBIT does not disregard the very important and legitimate place of tax-exempt organizations in our society.

Respectfully submitted,

WILKES, ARTIS, HEDRICK & LANE, Chartered

By
John D. Lane

By Joseph Whitebread, Jr.
Joseph B. Whitebread, Jr.
4/15/88

Attorney's for American
Association for the
Advancement of Science

COMMENTS

BY THE

AMERICAN ASSOCIATION OF MUSEUMS

Mr. Chairman, the American Association of Museums (AAM) is pleased to respond to the March 31, 1988, request of the Ways and Means Subcommittee on Oversight for public comment on the discussion of options relating to the unrelated business income tax. As you know, on June 26, 1987, the AAM testified during the Subcommittee hearings on UBIT, and submitted further comments to the hearing record on August 13, 1987.

Our submission includes detailed comments on several of the options raised in the Subcommittee's March 31, 1988 press release. Before beginning that discussion, however, it is important to describe briefly what museums are and what museums do. These considerations must be raised at the beginning of a discussion of UBIT because several of the options proposed by the Subcommittee, if enacted, will have a very real and far-reaching negative impact on the capacity of the museum community to meet its responsibilities to its collections, visitors and to future generations. In addition, there must be no doubt that enactment of several of the options will cause museums all over the nation to consider reductions in hours of operation, cutbacks in conservation efforts, staff layoffs, higher admission fees, and elimination of educational programs.

First, museums are repositories of unique and irreplaceable items held in trust for the people of this nation. A natural history museum's collection of biological specimens that record the earth's history cannot be replenished. Neither can the vanishing species maintained at a zoo or the artworks hung on a gallery's walls ever be replaced. A security lapse or a conservation cutback that damages a revolutionary war drinking mug means that it is gone forever. These losses of museum collections are not abstract concerns, but real-life consequences of reducing the museum's financial resources.

Museums are also a community of institutions consisting of over 6,000 tax-exempt organizations, including art, history and science museums, historic houses, science and technology centers, aquariums, botanical gardens, arboretums, nature centers, zoos, children's museums, park museums and visitor centers. These are found in every part of the nation, from the smallest rural county to the largest urban center. In order to give the Subcommittee a sense of the variety of the nation's museums, enclosed is an exhibit which lists the museums located in the state of each Subcommittee member.

Approximately forty-nine percent of museums are private tax-exempt organizations, thirty-five percent are governed by state and local governments, nine percent are governed by public universities and colleges and six percent by the federal government. One-half of all museums are historical museums, most of which are small institutions with collections consisting of objects indigenous to the community or region in which the museum is located. Approximately three-fourths of all museums have annual budgets below $250,000 annually. Regardless of the type of museum or size of its budget, however, each depends upon a variety of revenue sources to maintain the resource base necessary to fulfill its responsibility to the American public.

Second, the Subcommittee should consider what museums do. The discussion of UBIT has focused upon the intersection of tax-exempt and taxable organizations in the marketplace and, where the intersection occurs, the nature of the activity carried out by the tax-exempt organization. Is it related to the purpose of the tax-exempt organization and, if so, what is the extent of the relatedness? Without an appreciation of what museums do, neither the analysis of the perceived competition between museums and taxable entities nor the nature of the museum's activity can be understood.

The purpose for which all museums qualify for tax-exempt status is educational, or in the language of the IRS regulations, "to instruct the public, and to enhance its awareness of, interest in, and appreciation of the institution's collection of materials." Whether the museum displays works of art, historical objects, animals, vegetation or scientific principles, it fulfills its educational purpose by presenting physical displays of objects and ideas which otherwise might not be available or understood by the public.

In order to instruct and to increase awareness, interest and appreciation, museums must rely significantly on creating an environment that not only attracts the public, but meets the necessarily high standards imposed by a commitment to ever increasing educational programs and exhibitions and, at the same time, preserving the fragile objects that the institutions hold in public trust. The objects and ideas presented in a museum do not offer the sort of tangible benefits to the observer that a university offers its students or a hospital offers its patients. A student attends a university - at least in large part - because a degree offers an opportunity for more satisfying employment. A patient, of course, enters a hospital because it offers treatment for injury or disease.

The income producing activities carried out by art museums, zoos, aquariums and local history museums are intertwined with creating the environment that attracts people to the institution and enhances and extends their awareness and appreciation of the museum collection. These activities rarely compete with taxable organizations - let alone compete unfairly. In fact, museums make extensive use of third party vendors in such areas as food service, artifact manufacture, publishing and tour operation, all of which substantially benefit small businesses across this country.

The Subcommittee also must consider these options in the context of the financial environment in which museums operate today. Museums are attracting ever increasing numbers of visitors through their doors ranging from schoolchildren to senior citizens to guests from other countries. This upsurge in public interest has created great demands on museum facilities, on their staffs and on their financial resources. Yet, during this period of increasing interest, federal cultural funding has stagnated, and the funding for the two largest arts and cultural agencies has lagged the national rate of inflation by over twenty-six percent. Furthermore, the long-term fiscal health of museums is threatened by the wild swings that have characterized the financial markets in recent months.

The stagnant level of federal funding has been accompanied by the 1986 changes in the federal tax laws that are already having a negative impact in some areas. The Association of Art Museum Directors, for example, has reported that donations of works of art are down fifty-eight percent in the past year due largely to the reduction in federal tax rates and the inclusion of appreciated property in the alternative minimum tax. Some evidence also suggests that termination of the deduction for nonitemizers has adversely affected contributions to museums.

The substantial expansion of the unrelated business income tax can only exacerbate the existing difficulty of maintaining adequate financial resources to conserve collections and educate visitors. The Subcommittee has demonstrated its concern about the impact of current law on commercial businesses, but it cannot ignore the impact of further change upon museums.

Given the serious impact of these options on museums, it would be reasonable to expect a significant body of evidence to support the proposed changes. However, the need for the kinds of change embodied in these options has no foundation in the hearing record of this Subcommittee nor in any other authoritative source of which we are aware. The Oversight Subcommittee option paper, for example, states that questions have been raised about merchandise sold through gift shops, bookstores, or mail order catalogs of museums and other cultural institutions.

In fact, no such questions were raised in the hearings conducted by the Subcommittee in the summer of 1987. The hearings lasted five days and resulted in 2,361 pages of testimony and statements. Dozens and dozens of individuals, businesses and tax-exempt organizations either testified or submitted statements for the record. Throughout this entire hearing record, we know of only one passing reference to a museum that competed unfairly with a taxable business. Chairman Pickle stated explicitly on page 1145 of the hearing record that he sensed no real competition between tax-exempt arts and cultural organizations and taxable organizations.

The testimony of O. Donaldson Chapoton, Deputy Assistant Treasury Secretary for Tax Policy, Lawrence B. Gibbs, Commissioner of the Internal Revenue Service and Jennie S. Stathis, Associate Director of the General Accounting Office, expressed support for the current test of substantial relatedness, and Secretary Chapoton specifically stated that the fragmentation rule which applies to museums works satisfactorily. None of the three witnesses indicated in any way that museums posed any special problems in the administration or enforcement of the UBIT rules.

The witnesses also included Frank Swain, the Chief Counsel for Advocacy at the Small Business Administration, and Joseph P. O'Neil of the Business Coalition for Fair Competition. Neither of these witnesses mentioned museums as unfair competitors - or, even as competitors - of taxable entities. Literally hundreds of pages were devoted to the general activities of many other tax-exempt entities and hundreds more to specific activities that were considered unfairly competitive by small business. By contrast, museums and museum activities drew a single passing reference by one witness on one page.

Given the fact that a strong relationship exists between the income producing activities of museums and their tax-exempt purpose, and an almost total absence of allegations of unfair competition, the threshold requirement for demonstrating the need for a change in the current UBIT law has not been demonstrated. For this reason and others, such change should not be undertaken.

Chief among the Subcommittee options which will have a serious negative impact on the capacity of museums to fulfill their tax-exempt purpose are those dealing with changes to the substantially related test and elimination of the convenience and royalty exclusions. The first two proposed changes to the substantially related test involve its replacement by a test of direct relatedness or an activity-by-activity test of relatedness. The third proposed change purports to retain the substantially related test with certain enumerated activities explicitly excluded from its coverage.

The scope of these proposed changes suggests strongly that the substantially related test is somehow deficient. In fact, none of the government witnesses has suggested anything even approaching such Draconian changes. Assistant Secretary Chapoton testified that the relatedness test worked satisfactorily, although its interpretation may not always be correct. Commissioner Gibbs did not indicate a problem with the substantially relatedness test. Problems of interpretation may exist, and the IRS may not regulate with sufficient strictness. Even if this is so, however, the introduction of a new standard of direct relatedness that overturns years of precedent will only increase uncertainty over the meaning of relatedness and cause wider disparities in enforcement.

The substitution of a directly related standard is likely to have severe repercussions on museum activities. It suggests that only items sold in a museum shop that are reproductions of the objects in the museum collection can avoid UBIT. For example, UBIT apparently would apply to utensils reproduced according to colonial designs and sold in the shop of a museum of colonial American history if the museum contained only fabrics and furniture from the colonial period. Clearly, these utensils bear a close relationship to the educational purpose of the museum, because they demonstrate an important aspect of colonial life in America, yet it could be argued that the utensils do not bear a direct relationship to the items in the museum's collection. Such a standard does not add clarity to the process, and can only make it more difficult for museums to enhance the public's awareness, appreciation and interest in the museum's collection.

The suggestion of an activity-by-activity approach to determining relatedness is similar to the current treatment of items sold in museum shops. The so-called fragmentation rule requires an analysis of each separate income-producing item in the inventory to determine if it meets the test of contributing importantly to the accomplishment of the exempt purpose of the museum. The fragmentation rule was endorsed by Secretary Chapoton in his testimony. We do not believe, however, that the fragmentation rule should be elevated to the level of a statutory requirement for all tax-exempt organizations. Such a change would disrupt the long line of precedent that currently exists and create a chaotic situation. In addition, we think expanding this rule beyond its present application would create enormous administrative problems for the IRS. Museums have become accustomed to meeting this rigorous test, but to apply it across the board to all tax-exempt organizations will overwhelm the resources of the IRS.

The third general option contained in the Subcommittee press release with respect to the test of substantial relatedness proposes to carve certain activities out of the rule's scope. Included among these activities is gift shop/bookstore income with certain exceptions, "off-premises" sales, travel and tour services and, indirectly, advertising. These proposed changes will have a serious, negative impact on museums.

The option establishes a general rule that UBIT applies to gift shop/bookstore income unless such income falls within certain exceptions, including, among others, the sale of low-cost mementos or of educational items which relate to the organization visited. This is a significant departure from current law and to a large extent emasculates the substantially related test. Under current law, the substantially related test involves an analysis of the museum's purpose. Thus, items of a similar historical period or geographic location can be substantially related. The proposed option looks only at the organization itself, and not at its purpose. Such a standard would make taxable activity out of purely educational ventures. Presumably, an art book sold in connection with an exhibition of an artist's work would become unrelated when the exhibition ended. Scientific toys illustrating astronomical principles would be taxable if the science museum was devoted to aeronautics rather than astronomy. This proposed option would create an extraordinary array of anomalous results that would dwarf the complexity of the current fragmentation rule. It would also have the paradoxical result of favoring the sale of souvenirs over educational materials.

As a corollary, the proposed option also applies UBIT to income from all catalog and mail/phone order or other "off-premise" sales (with the exception of de minimis sales to the extent of on-premises sales). It is important to note that the prohibited sales described in this option have nothing to do with whether or not the items sold are related to the museum that makes them available. The option would apply even to items whose degree of relatedness is unquestionable. In fact, since the fragmentation rule in current law already applies to such sales, a high degree of relatedness must always be demonstrated with respect to such sales.

Since relatedness has no bearing on this option, we can only assume that the rationale behind its suggestion is that such activity is inherently commercial. The test for what is inherently commercial is no less difficult to define than the test of substantial relatedness. Certainly the test ought to consider whether any outright commercial enterprises believe the activity is competitive. As we noted in detail earlier, no such allegations were made with respect to museum "off-premises" sales in over 2,000 pages of testimony and records. In the face of such a total lack of criticism, the dismissal of the principle of relatedness in an area of activity vital to museums is not defensible.

Virtually all museums maintain museum shops and many also operate a merchandise catalog sales program. The single most important function of the museum shop is to perpetuate the experience of the visit, a goal that is not consistent with an inherently commercial objective. The objects for sale are carefully selected to include reproductions or other items related to the collection that will enable the visitor to reflect upon the visit. The educational nature of the items is enhanced by descriptive material. Catalog sales are somewhat different since the catalog purchasers are not necessarily recent visitors to the museum. Nevertheless, the catalog items are intended to educate the purchaser and to encourage a visit to the museum. The format of the catalog is devoted to providing educational as well as sales information.

The decision of the museum shop and catalog director is based upon a set of considerations that go far beyond questions of profitability or commerciality. First and foremost, the museum's curatorial staff is consulted on the selection of the items, the content of the descriptive material that accompanies their sale, and the nature of their presentation for sale. All of these steps are undertaken to assure that the educational mission of the museum is enhanced by its museum shop inventory and catalog. In addition, once selected, items are held in inventory for a much longer time than would be true of a commercial retail store.

The current rules with respect to what constitutes related income from sales have been developed through ruling requests, general counsel memoranda and other directives. We believe these rules are now generally understood and accepted. The test for relatedness is fact-based and applied separately to each item. Museums must select items that specifically relate to the museum's collection or exhibitions and are educational. Thus, reproductions and adaptations of items in a collection or exhibition produce related income. Interpretive items or period items accompanied by descriptive materials also produce related income.

It is very important to emphasize the scope of items museum shops can sell on a tax-free basis. The requirement that the museum shop or catalog inventory be related to the museum's tax-exempt purpose imposes limitations to which no other retailer is subject. In addition, it means that museums cannot and do not select items on the basis of what will sell the most or produce the greatest return. The first consideration is always whether and to what extent it relates to the collection.

With respect to any item that is not in or adapted from the museum's collection or an exhibition, is not accompanied by descriptive information of a substantial nature, or otherwise derived from collections and exhibitions, tax will be imposed. This narrow museum shop inventory cannot compete with a commercial enterprise. No commercial enterprise would be willing to carry only items found in a particular museum. No commercial enterprise would be willing to maintain in its inventory for a prolonged period of time items that reflected the historical period of a particular museum's collection even if the items did not sell. Museum shops, however, must operate under these limitations.

Moreover, the items carried in the shop or catalog are often the work of highly-skilled craftsmen and other small business entrepreneurs, who if not for the museum shop, would have no outlet for their services. Neither museums nor museum shops and catalog sales organizations are self-sufficient operations. Rather, they rely heavily on commercial suppliers for the production of the items they sell. Thus, the general commercial climate is enhanced rather than diminished by museum shops and catalogs.

The next area to be singled out is travel and tour services provided by tax-exempt organizations. Here, unlike the options described above, there have been substantial allegations of unfair competition although none have been directed against museums. It is true that some museums provide travel and tour programs, but, with a single exception (of which we are aware), all these services are provided through the auspices of a commercial travel company. It may be that such a service is provided by a wholesaler instead of a retailer, but surely, it is not an unfair competitive practice by the museum to use the service that provides the best deal. Must a museum use the most expensive travel service in order to avoid UBIT? If so, it is likely to give up the service entirely since the price would preclude so many people from making use of it. This, of course, would reduce rather than increase the number of people travelling. It would also reduce the amount of business museums give to whatever part of the travel industry they find most competitive.

The proposed change to the calculation of UBIT arising from advertising income also has serious, negative implications for museums. Many museums and museum service organizations that are also tax-exempt produce educational periodicals and other types of books. The current rules and case law with respect to the treatment of advertising income in connection with these activities already places tax-exempt organizations in a disadvantageous position by restricting the expenses (particularly overhead) which can be applied against advertising income. To limit the deductions that can offset advertising income to the direct expenses of the advertising subjects tax-exempt organization publications to rules that are much more strict than those applicable to commercial publications. The irony of the proposal is that those organizations able to continue publishing would be encouraged to reduce editorial content and educational substance since such costs could not offset advertising income.

The final option with deep significance to museums is the repeal of the royalty exemption. The passive income exemption is of enormous importance to museums and other tax-exempt organizations, and the royalty exemption is consistent with the purpose of the passive income exemption. A royalty, regardless of its measure, does not create management burdens for the organization, nor does it divert attention from the tax-exempt purposes of the organization. The key issue, which is sometimes obscured in discussion of UBIT, is whether the organization is performing services in furtherance of its tax-exempt purpose or whether it has been overtaken by commercial and revenue-raising zeal. Royalty arrangements do not run the risk of the latter and for that reason the exemption should be preserved.

The royalty proposal is somewhat confusing with respect to the relationship between property subject to UBIT because it is created by the tax-exempt organization and property that is not subject to UBIT because it is a part of the organization's exempt function. We presume that articles related to a museum's exempt purpose which are commissioned by the museum and sold in its shop would (absent other changes to the relatedness test) not be subject to UBIT. Museums do occasionally commission or purchase such items becuase they are not otherwise available.

Mr. Chairman, we conclude our comment by suggesting that the options proposed for consideration by the Subcommittee cannot be analyzed in abstract or isolated terms. A great many of them will have a real and negative effect on museums. The fact is that the substantially related test, as Treasury and the IRS testified, works. If problems exist, they should be dealt with by better enforcement of the current standards instead of the imposition of new standards. Improved enforcement is the important issue which the Subcommittee ought to examine, and, if necessary, promulgate recommendations.

The very serious and adverse general impact of these options on the vast majority of tax-exempt organizations cannot be ignored. Museums and others non-profit organizations bring knowledge and pleasure to huge numbers of people. They employ thousands of Americans, from the multi-degreed to the unskilled. They contribute to their local economic development and provide essential services. They attract tourist dollars and help stabilize inner cities. To the extent these proposals compromise the capacity of museums to meet these diverse and important goals, any changes to the present law must be approached with great caution, and these particular discussion options rejected.

[Exhibit listing Association Museums located in Subcommittee Members' states are being retained in the Committee files.]

AANA

April 14, 1988

Robert L. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax
Response to Discussion Option

Dear Mr. Leonard:

The American Association of Nurse Anesthetists (AANA) represents over 24,000 nurse anesthetists in the United States. Nurse anesthetists administer over one-half of the estimated 20 million anesthetics given in this country annually. In recent years, the AANA has entered into passive programs which offer services to its members. These programs provide the AANA with royalty income for the use of the AANA name and trademark in marketing these programs. The AANA is involved in forming a for-profit subsidiary company to engage in the business of printing, and publishing newsletters, journals and magazines for not only the AANA, but also other nursing specialty organizations.

This letter is in response to the Subcommittee on Oversight Press Release dated March 31, 1988, requesting comments on several "discussion options" relating to unrelated business income tax (UBIT). Specifically, this letter addresses the proposal to apply UBIT to income from royalty programs, a minimum tax when a controlled subsidiary is involved, and miscellaneous items suggested in the press release.

The AANA annually receives approximately $275,000 from its insurance programs of which $250,000 is generated from a sponsored professional liability program. These funds have been used by the AANA to develop an anesthesia risk management guide and quality assurance manual, to perform closed-claim studies on nurse anesthesia losses and present risk management seminars to nurse anesthetists. Because of the importance of risk management to patient safety, we are presently establishing a risk management department within the AANA to carry on these functions on a full-time basis. The fruits of our efforts over the past four years are just now being realized.

American Association of Nurse Anesthetists 216 Higgins Road, Park Ridge, Illinois 60068-5790 (312) 692-7050

Nurse anesthesia liability losses have decreased from a high of $16.6 in 1984 to an estimated $7.6 in 1987. This decrease can be attributed to loss prevention programs, manuals and additional monitoring techniques financed through these insurance royalties. If the staff recommendations concerning royalty income are implemented they would severely affect our ability to carry on these worthwhile programs which benefit not only nurse anesthetists but also improves patient safety.

In the case of controlled corporations the option to apply a minimum tax, the greater of the controlled corporation's tax or UBIT if consolidated within the not-for-profit discriminates against for-profit subsidiaries.

The establishment of a for-profit subsidiary is being done so to protect the tax-exempt status of the AANA. This subsidiary will carry on in the same manner as any business, taking extra care to ensure transactions between the AANA and the subsidiary are on a fair market basis and at arms length. The subsidiary will be responsible for printing and publishing the AANA's newsbulletin, scientific journal and other materials and for printing outside nursing organization's printed matter. The subsidiary will charge the Association a fee based upon fair market value for all services performed as will the AANA charge the subsidiary. The income received by the AANA in this relations will be considered in developing UBIT. The subsidiary will apply the same tax regulations over revenues and expenses as other competitors.

To tax this subsidiary in a manner different than competitors would affect its ability to compete in the marketplace and would provide similar businesses with a financial edge.

I found the miscellaneous category of the discussion options interesting in that it was very general. If you have any information concerning what the specific staff recommendations in the miscellaneous category are I would appreciate receiving it.

We feel there could be some modification to the present UBIT inclusions/exclusions, however, we feel these specific staff recommendations would severely affect the public service which many tax-exempt organizations perform. In our own case, if the discussion options are legislated, our tax liability would increase from $80,000 to $350,000-$400,000 annually. This is a significant difference and one which an organization with $4.2 million in revenue and expenses could not manage at the present time without significant cuts.

In summary, we believe that the current law exclusion of royalty income is consistent with a sound tax policy of permitting tax-exempt organizations to passively invest their property without being subject to tax and the present policy of treating controlled corporations on the same tax basis as competitors is a fair and equitable method. We feel any changes to these policies would be unnecessary and inappropriate. Thank you for this opportunity to present our views.

Sincerely,

Mark R. Krzmarzick

Mark R. Krzmarzick
AANA Director of Membership and Finance

Submitted by
Edward C. Schmitt, AAZPA Legislation Committee Chairman
and
Kristin L. Vehrs, AAZPA Legislative Representative

MR. CHAIRMAN:

The American Association of Zoological Parks and Aquariums (AAZPA) submits these comments on the discussion options circulated by your Subcommittee on unrelated business income tax. We thank you for the opportunity to participate in this process. These comments were prepared by Edward C. Schmitt, Chairman of the Legislation Committee and Kristin L. Vehrs, Legislative Representative.

The AAZPA is the largest professional zoological park and aquarium organization in the world. AAZPA represents virtually every major zoological park, aquarium, wildlife park and oceanarium on the North American continent and the vast majority of the professional staff members employed therein. AAZPA also represents and is the official spokesman for nearly 300,000 members of various zoological park and aquarium support organizations that offer assistance to zoological facilities in their communities. Collectively zoos and aquariums in this country annually play host to more than 100,000,000 visitors.

AAZPA is concerned with several of the proposed options; particularly those relating to the "substantially related" test described in Option I. The "substantially related" test is a very precise test which has been fine tooled over the past 40 years through statute, case law, Internal Revenue Service private letter rulings and audits. We believe that in most circumstances the "substantially related" test has worked in the zoo and aquarium field. We also contend that, to our knowledge, zoos and aquariums and our related activities are not in direct competition with private enterprise.

If aggressively and properly enforced, the "substantially related" test is very effective in limiting tax-exempt status to those activities that are substantially related to the organization's tax-exempt purpose. We believe that it is rather persuasive that even the Internal Revenue Service and the Department of Treasury did not request changes in the "substantially related" test during the recently held hearings.

Herein follows a discussion of several of the specific options proposed.

1. Repeal "substantially related" test and replace it with a directly related test.

   This is not a modest change to the law. The effect would be that books or numerous other related items in a zoo or aquarium gift shop not represented in that facilities' collection would not be tax-exempt. This will be an administrative nightmare and very burdensome as each item would have to be separately considered.

2. Determine whether each income-producing activity standing alone is tax-exempt.

   This procedure would also be very time consuming and burdensome for tax-exempt organizations. Even if all the items which are now tax-exempt were to remain so under this proposal, the burden of justifying each item as tax-exempt is enormous.

3. Retain "substantially related" test; however, impose UBIT on specified activities whose nature and scope are inherently commercial, rather than charitable.

   Although this option describes retaining the "substantially related" test, it is a major departure from it. The test no longer relates to the overall educational purpose of the facility for which it originally received tax-exempt status but would now relate to what is actually physically maintained in that facility. We are uncertain as to what the term "inherently commercial" includes and believe it may take considerable time to establish a definition for that term.

One of the exceptions to UBIT would be for on-premise sales of low-cost mementos. There would have to be a determination as to what is low cost. We do not believe that this is a retention of the "substantially related" test because these items do not have to be related to the reason for the organization's tax-exempt status.

Another exception to UBIT would be for on-premise sales of an educational nature which relate to the organization visited. These rules would tax all zoo shop sales of items that do not both relate directly to the zoo's own collection and qualify as "educational". We further question what would be required for an item to be of an "educational nature".

These two exceptions if read in concert suggest that selling a T-shirt that says XYZ ZOO would be exempt but selling a book on the general biology of mammals would not be tax-exempt if the XYZ ZOO doesn't display all mammals represented in the book. We believe this changes the test to one narrowly related to the organization visited and not to the broad educational purposes of the facility.

The options call for the application of UBIT to income from all catalog and mail/phone order or other "off-premise" sales (with exception for de minimis sales, in relation to amount of "on-premises" sales). All off-premise sales would be taxable, even if the materials were educational or otherwise supported exempt purposes. This is again not a retention of the "substantially related" test.

The options call for the application of UBIT to travel and tour services (except those provided by colleges and universities to students and faculty as part of curriculum). Currently, travel and tours sponsored by a zoo or aquarium are transacted through commercial third parties and thus are not affected by current UBIT interpretation.

In sum, AAZPA views the options described above as major changes to the existing "substantially related" test. We believe these changes would have a significant impact on zoo and aquarium earned-income activities. The financial impact would be great but the administrative impact would be even more disastrous.

Moreover, we do not believe these changes are needed and continue to support enforcement of the existing regulations regarding substantially related activities. Zoological parks, aquariums and other cultural institutions are being included in the broad scope of the issue and yet history indicates that our institutions are not part of the problem. In conclusion, AAZPA is concerned that some of the proposed changes will have a result inconsistent with the overall intent of tax-exempt organizations.

Again, thank you for the opportunity to comment on these discussion options. We would be pleased to discuss any of our comments with you or your staff. For further information, please contact Kris Vehrs at (202) 429-0949.

Edward C Schmitt

Edward C. Schmitt
Chairman
Legislation Committee

Kristin L. Vehrs
Legislative Representative

COMMENTS TO HOUSE WAYS AND MEANS SUB-COMMITTEE ON OVERSIGHT

Re: Unrelated Business Income Tax

From: Charles Dillingham
Executive Director

AMERICAN BALLET THEATRE

Seven and a half years ago when the Reagan Administration took office, the non-profit institutions of this country were told to prepare for greatly diminished or eliminated federal support, and consequently to plan to replace that federal support with income generated from the private economy. Although the diminution in support to non-profit organizations has not been as great as Reagan originally intended, most of us have had to contend with reduced support from the federal government. Difficult as this has been, most organizations have met the challenge of this shift in national fiscal priorities towards increased military expenditures.

It is sadly ironic then that a Democratically controlled congress is now seriously considering taxing many of the sources of income non-profit institutions have developed in response to the administration position. Even after almost 8 years of Republican attack, the America's non-profit sector remains one of its most healthy and vigorous national assets, and one that clearly sets American society apart from all other western countries, most of which deliver through governmental activity almost all the services provided in America by the non-profit sector.

American Ballet Theatre is one of the largest and, with its annual national tour, one of the most diverse of the performing arts companies in America. CONSEQUENTLY, MANY OF THE PROPOSALS BEING CONSIDERED BY YOUR SUB-COMMITTEE WILL RESULT IN A TAX ON AMERICAN BALLET THEATRE. In fiscal year 1981 ABT received over $900,000 in federal funding; in the current fiscal year, we will receive less than $400,000. We have successfully replaced this lost support through a wide variety of activities, most of which are outside the scope of your proposals. However, in searching for income wherever it could be obtained to support our ballet performances, we would be severely damaged if your proposals are implemented into law.

Specifically, your proposals regarding on-premise gift shop sales, off-premise sales, program advertising and mailing list exchanges and rentals would all result in substantial tax to American Ballet Theatre. A more detailed analysis than is possible during the short period you have allowed for comment will probably identify additional taxation resulting from options you are considering.

American Ballet Theatre strongly urges the Committee to refrain from viewing America's non-profit institutions as a potential source of additional tax revenue. The social costs of the resulting diminution of support to institutions is far greater than the effect that revenue will have on the federal budget.

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April 14, 1988

The Hon. J. J. Pickle, Chairman
Oversight Subcommittee
House Ways & Means Committee
c/o Robert J. Leonard, Esq., Chief Counsel
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I understand that the Oversight Subcommittee is considering certain options for the revision of the unrelated trade or business income tax and that one of the options being considered is to apply the unrelated trade or business income tax to "testing income".

I write to you on behalf of the 23 medical specialty certifying boards which are engaged in testing candidates who apply for certification as medical specialists. All of these boards administer written or oral tests to physician candidates who have completed the required training and who wish to become certified specialists. All of these boards derive their income from fees charged for these testing services. All of the boards have been determined to be exempt from federal income tax under provisions of Section 501 (c) (3) or (6).

I assume that your definition of "testing income" as noted in the first paragraph of this letter does not include the type of testing which is carried on by the medical specialty boards and that you exclude testing for professional certification.

Cordially,

Donald G. Langsley, MD
Executive Vice President

Comments of the
American Bus Association

My name is Norman R. Sherlock, and I am President and Chief Executive Officer for the American Bus Association ("ABA" or "the Association"). ABA represents more than 3,500 companies involved with bus regular route, tour and charter, and airport and commuter services, and in businesses that are related to travel and tourism.

ABA appreciates the Oversight Subcommittee's review of the unrelated business income tax laws, and welcomes this opportunity to comment on the discussion options now under consideration. ABA testified during your Subcommittee's hearings on the unrelated business income tax last summer, and since that time has maintained an interest in the deliberations. These comments are intended as an extension of that process in order to assist the Subcommittee in developing unrelated business income tax recommendations that are fair and appropriate.

Under current law, a tax-exempt organization is taxable if its income-producing activity is: (1) a trade or business; (2) regularly carried on; and (3) not substantially related to the organization's performance of its exempt function. The unrelated business income tax was enacted in response to perceived abuses of tax laws by tax-exempt organization that engaged in profit making activities. The Subcommittee's discussion options include the following: (1) a repeal of the "substantially related" test and its replacement with a "directly related" test; (2) a test involving a determination of whether each income-producing activity standing alone is tax-exempt; and (3) retaining the "substantially related" test and imposing the tax on specified activities whose nature and scope are inherently commercial, rather than charitable.

As an initial matter, ABA agrees with O. Donaldson Chapoton, the Treasury Department's Deputy Assistant Secretary for Tax Policy, who testified last summer that the "substantially related" test provides a sound basis for granting exemption from tax. ABA agrees that tax-exemption should appropriately extend to the collection of activities that are substantially or integrally related to the organization's exempt functions and that tax exemption should be denied to activities that simply duplicate private sector businesses without advancing the organization's exempt purposes. In particular, ABA agrees with the Subcommittee's discussion option that would apply the unrelated business income tax to travel and tour services conducted by exempt organizations such as schools, colleges, universities and churches.

As ABA pointed out in its testimony dated June 25, 1987, ABA members have faced increasing competition from and have lost business to tax-exempt schools, colleges, universities, churches and other groups that provide bus tour and charter services. Many of these tax-exempt entities are now providing tour and charter services to the general public or to tour groups - the traditional market of tax-paying, commercial charter bus companies. Consequently, ABA agrees with the Subcommittee's recommendation to apply UBIT to travel and tour services.

ABA maintains that the competition engaged in by tax-exempt organizations is inherently unfair because: (1) such organizations do not pay Federal, State or local taxes and (2) such entities are exempt from many Federal and state safety regulations that apply to private operators.

However, the Subcommittee recommends an exemption for services provided by colleges or universities to students or faculty as part of a degree program curriculum, as well as an exception for de minimus sales. ABA supports the exemption for services that are part of a degree program, as those services are provided in furtherance of the tax-exempt organization's religious or educational functions. However, ABA disagrees with the exception for de minimus sales of travel and tour service. This could allow colleges and universities to earn a substantial amount of tax-free income on sales to outside parties, so long as the sales qualify as "de minimus" sales in relation to the amount of sales that are conducted in furtherance of degree programs or on behalf of students. In addition, ABA maintains that the exception for services provided as part of a degree program curriculum should be carefully delineated.

The Subcommittee has also recommended that better tax information reporting and IRS administration is necessary. ABA agrees that compliance efforts should focus on obtaining more detailed information concerning the revenues of exempt organizations and the basis for treating them as tax-exempt. ABA maintains that the current Forms 990 and 990T are not sufficient to identify compliance issues. In addition, ABA suggests that the IRS strictly enforce current unrelated business income tax rules, improve its audit programs, and provide more information to enable tax-exempt organizations to comply with the current statutes. Currently, IRS non-profit reporting forms do not distinguish between activities that are related, unrelated, or exempted for purposes of applying the unrelated business income tax. Additionally, ABA commends the Subcommittee for proposing improved collection and analysis of tax-exempt data.

In conclusion, ABA maintains that the Subcommittee's options are a worthwhile starting point in determining the appropriate tax treatment of non-profit organizations. As stated above, ABA supports enforcement of the UBIT statute and development of additional data to determine the appropriate modifications to current law.

On behalf of the ABA, I would like to thank the Subcommittee for the opportunity to submit comments on this important issue.

STATEMENT OF FRANK M. WASHBURN

INTERIM EXECUTIVE VICE PRESIDENT
AMERICAN CAMPING ASSOCIATION

The American Camping Association (ACA) is a non-profit 501(c)(3) organization which has been providing educational assistance to organized children's camps for over 75 years. Our principal purposes include the provision of assistance in camp programming and management, the establishment and promotion of safety and health standards for camps, and the overall promotion of youth camping as a tool for sound educational and behavioral development.

The Association has concerns with select UBIT proposals now under review by the Subcommittee. We say this in full recognition that we are in the somewhat unique position of representing both the non-profit and for profit sectors of the camping industry.

We wish to briefly address the proposals relating to (1) bookstore income; and (2) routine testing.

(1) Bookstore Income: ACA maintains the largest selection of educational materials relating to organized camping available. Approximately one-third are self-published, essentially because they are unavailable through the private sector. The remainder are materials which are available elsewhere, but which are generally such low-volume items that commercial bookstores are not interested in stocking them.

The proposal before Subcommittee would tax essentially all income from our sales, as the majority is mail-order. We believe that to the extent the purpose of this provision is to put us on a "level playing field" with the private sector, it is misguided -- at least with respect to its effect on ACA. Self-published items which fill a void in available educational materials are by definition not in competition with the private sector. Likewise, to the extent that the commercial industry is not interested in what we have to sell -- given its specialized nature and incident low volume sales -- we offer no threat to the private sector.

In fact, taxation of this income serves only to increase costs to both commercial and non-commercial segments of organized camping. The impact would be disproportionately felt by the non-profit camps serving the underprivileged, as they rely more heavily upon printed materials rather that the more costly alternative of seminar and conference participation.

We recommend that the Subcommittee give serious consideration to amending the bookstore income/mail order income proposal as follows:

(i) Exempt self-published works.

(ii) Exempt the sale of educational materials by bookstores specializing in a single subject matter area in direct conformity with the organization's underlying purpose.

(2) Routine Testing: ACA conducts periodic reviews of its accredited camps to ensure continued compliance with health, safety, and other standards we have determined to be in the interest of youth camping. ACA is concerned that taxation of "routine testing" could be broadly interpreted to cover these internal reviews.

We recommend that any proposal be clarified to provide that the definition of "routine" does not include "testing" or "reviews" conducted by non-profit organizations for the purposes of determining compliance or qualification with internal standards and guidelines.

Respectfully submitted,

Frank M. Washburn
Interim Executive Vice President
American Camping Association
Bradford Woods
Martinsville, Indiana 46151
(317) 342-8456

Grover C. Williams, P.E., *President*
Trinity Engineering Testing Corporation
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American Council of Independent Laboratories, Inc.
1725 K Street, N.W., Washington, DC 20006

April 14, 1988
File: 66-88

The Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
House Ways and Means Committee
Room 1102
Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Pickle:

On behalf of the American Council of Independent Laboratories (ACIL), I am submitting these comments on the list of discussion options relating to the unrelated business income tax (UBIT) proposed by the Oversight Subcommittee and released to the public in Press Release #16, issued on March 31, 1988.

As President of ACIL, I presented testimony at the June, 1987 Subcommittee Hearings on UBIT and the broader subject of commercial activities by nonprofit entities. My testimony is printed on Pgs. 551 ff. of the Hearing Record.

ACIL commends the Subcommittee and its leadership for the serious attention that you have paid to the UBIT issue. The list of discussion options being considered demonstrates your thoughtful and careful approach to this important matter of public policy. In particular, we favor the first two options under Item I, regarding the substantially related test:

- Repeal "substantially related" test and replace it with a "directly related" test;
- Determine whether each income-producing activity standing alone is tax-exempt.

The "substantially related" test has failed miserably over the past 35 years, in our opinion. We urge you, therefore, to include the above items in the set of recommendations you forward to Mr. Rostenkowski.

Further, we favor the option that "activities whose nature and scope are inherently commercial, rather than charitable," should be taxed. In this light, we enthusiastically support the points made by two academic witnesses at the hearings: Professor Henry Hansmann of Yale Law School (Pgs. 1832 ff.) and Dr. Gabriel Rudney, of the Institution for Social and Policy Issues, Yale University (Pgs. 985 ff.) From a scholarly, objective perspective, both offer persuasive appeals for a major shift in the tax treatment of nonprofits from the "substantially related" test to the approach of section 501(m) of the Code, which is the "commercial nonprofit" approach. Dr. Rudney in particular provides a concise, workable alternative to present law. We would further suggest that the Subcommittee examine the analysis applied by the Utah Supreme Court to determine whether a nonprofit hospital was "charitable" or "commercial" in a recent significant judicial decision, Utah County v. Intermountain Health Care.

As many witnesses observed last June, there have been profound changes in the size, nature and activities of the nonprofit sector since the UBIT statute was enacted. Dramatic change dictates the need for dramatic, even radical, reform of tax laws affecting this sector. A tentative, band-aid approach to UBIT reform will not help. It may harm, by serving to embolden an already aggressive nonprofit community to accelerate the pace of its invasion of the commercial marketplace.

In short, ACIL continues to recommend that the Subcommittee make decisive proposals to curb blatant abuses. One such blatant abuse was amply documented in our testimony, namely, inclusion of "testing for the public safety" as a reason for exemption under section 501(c)3 section of the Code. We made a strong case for deleting this discrete exemption. No witness testified for its continuance; no written statements were submitted for the record in opposition to our position. ACIL was profoundly disappointed, therefore, to see the proposal of the Republican members of the Subcommittee to repeal the exemption reflected as a proposal to "Modify rules applicable to organizations 'testing for the public safety'".

To propose to "modify" that which is totally out of place in the list of worthy causes for exemption (charity, religion, education) is, in our opinion, to permit serious abuse of Federal tax-exemption to continue unabated.

Let me, more succinctly than in my original testimony, point out why "testing for the public safety" is an unjustified exemption.

- U.S. independent testing laboratories have been testing for the public safety for more than 100 years. Commercial chemical laboratories test food, drugs, water, air, hazardous waste and the like. Commercial engineering laboratories test, among other things, construction materials, consumer products, electrical components. The vast majority of this work is directly related to the safety and health of the U.S. public.

- From its origins, providing testing services for a fee has been considered a commercial enterprise, a business. It is one of many business activities where the public welfare is involved (for example, manufacturing sound airplanes and safe cars, and serving uncontaminated food.) As with all such business activities, it is the competence and integrity of the provider that matter, not its tax structure.

- Nevertheless, in 1943, one of the many U.S. commercial testing firms, Underwriters Laboratories, petitioned the Board of Tax Appeals for a grant of tax-exempt status. UL's request was denied, and the denial was upheld by the Seventh Court of Appeals.

- The Seventh Court of Appeals, in its ruling, made some important statements about testing for the public safety that are as true in 1988 as they were in 1943.

  "An individual purchaser of a piece of merchandise cannot get a test under any circumstances. In other words, the testing service is for the manufacturers who pay the ample fees that give the petitioner its large profits. As the Board observed: 'Undoubtedly, it could have established prices which would not have resulted in such substantial profits. Not having done so, it is reasonable to assume that it is intended to operate for profit.'

  "It was not the public interest that prompted the establishment of the petitioner. It was financial gain and business advantage. The primary concern of the petitioner was that of its membership...and the manufacturers who paid its ample fees. Whatever benefit the public received was not as a 'gift for public use'...but was to enable some one to sell something to the public by giving to the public something better than it otherwise would have received. That may be good business but it is not charity.

  "It (UL) did not operate on the basis of science. It was science for the sake of business. The fact that scientific methods were used does not alter the case. Most businesses today use some kind of scientific processes or methods.

  "We know judicially that many business concerns conduct commercial testing laboratories for profit. The business which (UL) was engaged in was a commercial testing laboratory, and of a kind usually conducted for profit, and is not exempt."

- In spite of the cogent reasoning of the Court and the long tradition of commercial testing-for-the-public safety firms bearing their fair share of the tax burden, the U.S. Congress, in 1954, inserted the phrase "testing for the public safety" in section 501(c)3 of Code, making this justification for tax exemption. Strangely, no explanation accompanied the addition.

- As a result of Congress' action, commercial testing suddenly became equal to religion, education and charity as a tax-exempt activity.

- Commercial testing businesses provide a vital service to U.S. industry, government and, ultimately, the public. Like other important U.S. businesses, they should pay taxes.

Moreover, ACIL suggests that Item H in Section I of the discussion options as currently drafted be deleted. Although the Subcommittee's intent is praiseworthy, "applying UBIT to routine testing income" leaves for-profit testing laboratories worse off than under present law when the parenthetical exceptions, particularly the exceptions for federal or state mandated activity, are included.

Finally, an additional disappointment to the tax-paying testing community is the fact that in the list of discussion options there is no mention of the current research exemptions. The need at least to review the particulars of these exemptions was cited by the Treasury Department in its testimony last June. In ACIL's testimony, we urged the Subcommittee to delete, as inappropriate and anachronistic, several blanket exemptions for research:

- The exemption of all research by nonprofits for federal, state or local governments;

- The exemption of research for any client by a college, university or hospital; and

- The exemption of research for any person by an organization operated primarily for purposes of carrying on fundamental research, the results of which are freely available to the general public.

We can only urge the Subcommittee that these exemptions have outlived their validity and are a source of serious problems of unfair competition in the testing marketplace. Please review the ACIL testimony for a fuller explanation of this position.

Thank you for this opportunity to present our views.

Sincerely,

Grover Williams

Grover Williams

AMERICAN COUNCIL ON EDUCATION
Division of Governmental Relations

April 15, 1988

Congressman J. J. Pickle
Chairman, Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax:
Response to Discussion Options

Dear Mr. Chairman:

On behalf of the higher education community, the American Council on Education submits these comments on the discussion options set out in the press release issued by the Oversight Subcommittee on March 21, 1988.

We would like first to express our gratitude for the consideration given by the Subcommittee and its staff to the views of the higher education community with respect to the Treasury position and the initial recommendations of the Subcommittee's Republican members. Of particular significance was the evident response of the Subcommittee to our analysis and argument concerning the preservation of the research exception, as applicable to applied as well as basic research. It appears, on the basis of the press release, that you have made the decision to retain the research exception in its present form, and we applaud that decision. In other respects as well, the discussion options indicate the sensitivity of the Subcommittee to the needs and special concerns of the higher education community.

"Substantially Related" Substitutes

The Subcommittee's first option would repeal the "substantially related" test. In its place would be either a "directly related" test, or a new requirement that each income-producing activity standing alone qualify as tax-exempt.

It is impossible to analyze the effects of adopting a "directly related" test, since there is no indication of what a "direct" relationship would mean, or how it would differ from the present statutory standard. Presumably the purpose of making such a change would be to tighten the applicable standard, but there is no way to predict just how much weight the Internal Revenue Service would give to such a presumption, and there would be no solid basis for exempt organizations to make judgments as to the tax consequences of their operations. In the face of such confusion the ability of exempt organizations (particularly colleges and universities, already subject to inherent financial uncertainties) to make prudent financial plans would be diminished. Moreover, the body of knowledge and experience built up in connection with the "substantially related" standard would be lost. It seems clear that by changing from one subjective standard to another, both exempt organizations and the Internal Revenue Service would lose much and gain little.

The second of the alternative tests suggested would require each income-producing activity of an exempt organization to qualify separately as tax-exempt. Present law, through the fragmentation rule, does require an evaluation of activities on an item-by-item or transaction-by-transaction basis, in order to determine whether the activity contributes importantly to the accomplishment of a charitable or educational purpose. This new test would apparently require each activity of an exempt organization to qualify independently as charitable or educational, without reference to the charitable or educational context in which it is carried on. Such a requirement -- particularly in combination with any repeal or limitation of the convenience exception -- would be a major and unwarranted departure from present law.

Colleges and universities operate dormitories and other living facilities; sponsor student social events and alumni/ae gatherings; sell tickets to athletic events; maintain xerox machines in libraries; offer parking facilities in connection with educational programs; and conduct a variety of activities for which some separate charge is made, or for which an allocable part of general tuition charges could be calculated. All of these functions are important and appropriate in context, although it is not clear that they could qualify for exemption as educational activities if viewed in isolation. To determine the taxability of such activities without regard to the organization's broad purpose in undertaking them would be highly artificial. We believe that such a standard would create massive confusion, without advancing in any way the policies of the unrelated business income tax.

"Inherently Commercial" Activities: The Approach

The Subcommittee's press release indicates that, if the "substantially related" test is preserved, tax might be imposed on specified activities "whose nature and scope are inherently commercial, rather than charitable." Before addressing any of the activities that are singled out for taxation, we want to emphasize that this approach, which suggests some judgment as to commerciality but which does not specifically depend on it or define it, is quite troubling. The eleven areas specified are, almost precisely, those areas in which witnesses at the Subcommittee's June, 1987, hearings raised particular complaints. This suggests to us that any statutory list of "inherently commercial" operations is likely as a practical matter to become a purely political list, always subject to expansion for any particular activity in which a vocal business group has an interest. This kind of ad hoc approach to the operations of the non-profit sector seems to us extremely undesirable, particularly since later additions to the "inherently commercial" list are likely to receive much less thorough and thoughtful consideration than the initial selection.

Allocation Rules

The press release suggests that, with respect to facilities used for exempt as well as unrelated purposes, deductions should be allowed in computing unrelated business taxable income for a pro-rata share of direct operating costs, but not for any part of the organization's overhead expenses or for depreciation.

This proposal is apparently a response to concerns that some organizations may have been allocating a disproportionate share of overhead costs to unrelated activities. It is, however, a truly draconian response to what is essentially a tax accounting problem of the kind that would normally be remedied by administrative action. If some organizations are not correctly calculating their taxable income, more precise allocation rules can be set out in regulations or rulings, in the same manner as rules for the deduction of business expenses for purposes of the regular corporate tax.

If it appeared that profit-making corporations were claiming excessive deductions in some areas, the response of the Congress and the Treasury would not be to require taxation of businesses on their gross income, but to redefine or re-emphasize the requirements for deduction. Similarly, if the Treasury now believes that some errors are being made in the calculation of unrelated business taxable income, that problem should not be remedied by requiring exempt organizations to pay tax on what in some cases would be close to a gross income basis. Any such requirement would be inconsistent with the fundamental assumption that our system taxes net income. On a practical level it would result in taxation of unrelated business activities at a much higher effective rate than comparable commercial businesses. This result would contravene the basic principle of the unrelated business income tax, that exempt organizations which carry on unrelated activities should be subject to tax on the same basis as the business entities with which they may compete.

Royalty Exception

The press release suggests that the current exception to the definition of unrelated business taxable income for royalties should be modified to exclude (and therefore expose to tax) any royalties measured by net or taxable income, and any royalties derived from the use of property created or developed by the exempt organization. As we have indicated in earlier submissions, we would in general not oppose elimination of the exception for net profits royalty arrangements, notwithstanding the fact that narrowing of the royalty exception is likely to have a significant adverse impact on a number of our colleges and universities.

We believe very strongly, however, that there is a compelling need to preserve the royalty exception as it applies to technology transfers by colleges, universities, and university hospitals. Technology transfers have traditionally been accomplished -- and are best accomplished -- through a licensing or royalty arrangement. Because it is impractical to impose a large fixed-cost royalty on an untested product, such arrangements are best suited to a sharing of net profits. The interests served by excluding such net profits royalties from the tax are not simply interests of the higher education community. There are significant national interests at stake, as indicated by the adoption of legislative and regulatory policies that favor technology transfers; and there are substantial business interests at stake as well, particularly within the small business community.

In our testimony of June 25, 1987, we described the critical role of technology transfers in enabling small businesses to enter and to compete effectively in the area of technological development and production. Studies by faculty at the Massachusetts Institute of Technology, for example, have identified over 1000 new businesses that began with ideas and technology from the Institute. This is the case with university technology licensing programs all over the country, which have allowed new businesses to produce a range of important, and profitable, new products. Our testimony also emphasized the role that the Congress has played, through enactment of the Uniform Federal Patent Policy Act and similar measures, in facilitating and encouraging such technology transfers. The particular examples set out in our statement could be documented and multiplied. By contrast, we believe that you would find few if any complaints of unfair competition among commercial firms involved in technological development.

It is thus widely recognized, within the industrial sector and the government, that technology transfers serve critical national and business needs, and that any disincentives to such transfers should be eliminated. Creation of new and substantial tax disincentives, in the face of this broad consensus, would be evidently and significantly counter-productive.

We also believe that the total elimination of the royalty exception for use of property created or developed by the exempt organization would unnecessarily limit the ability of organizations to enter into royalty arrangements, with royalties based on gross sales or gross income, for the licensing of intellectual property. Such arrangements (copyright contracts, for example) have not been the subject of challenge on competition grounds, and we do not believe that they are properly subject to challenge on policy grounds. We strongly recommend, therefore, that the statute preserve the royalty exception for licensing of intellectual property on a gross income basis, as well as for technology transfers without respect to the basis for calculating the royalty payment.

Convenience Exception

The press release proposes a repeal of the general "convenience" exception, as well as changes in what is now the application of that exception in specific areas. It is not at all clear what purpose would be served by elimination of the exception, once particular perceived abuses have been addressed. It is, however, quite evident that loss of the exception would increase the level of uncertainty and unpredictability in the administration of exempt organizations.

Colleges and universities, for example, operate dormitories and campus shuttle buses, maintain vending machines and laundry services for students, and particularly in rural areas offer a variety of small services and necessities to facilitate life on the campus. If these various activities were to lose the protection of the convenience exception and were instead to be tested under the "substantially related" standard, the effect, in a perfect world, would be minimal, since such activities are in fact undertaken in order to further (and thus are related to) educational purposes. In the real world, however, application of the standard would occur in an audit context, with an agent making judgments that may be awkward at best when applied to things like dormitory amenities. The effect of such uncertainty could be substantial. If an agent were to determine, for example, that sales of candy bars in a dormitory vending machine or easy access to xerox facilities in a library did not further the institution's educational function, it would be troublesome and very expensive to challenge or appeal that decision.

What is at stake in debating repeal of the convenience exception is not really principle -- since any significant issues involving ancillary facilities are addressed in the other options -- but rather predictability for exempt organizations and administrability for the Internal Revenue Service. The exception currently serves an identifiable, useful purpose; its elimination would serve none.

Bookstores

The press release suggests (as the first of the rules for "inherently commercial" activities) that income of campus bookstores be subject to tax, with exceptions for on-premises sales of low-cost mementos, on-premises sales of an educational nature which relate to the organization, articles in furtherance of educational programs, low-cost items, and a limited number of computer sales. All "off-premises" sales in excess of some de minimis amount would be taxed.

We believe that viewing campus bookstores overall as inherently commercial is contrary to fact, as the detailed data submitted to the Subcommittee by the National Association of College Stores demonstrates. Any set of restrictions that begins from that characterization is therefore likely to create unintended problems and uncertainties. Although we recognize the purpose of the specific suggestions for bookstore taxation set out in the press release, we are concerned that this kind of rule (a presumption of taxability with specified exceptions) may lead to some surprising and inappropriate results.

For example, because of the lack of available on-campus space, a number of college and university bookstores are located a short distance off campus. Since the proposal would tax all "off-premises" sales without regard to educational value, all of the books and supplies sold to students at these schools would be subject to tax. The off-premises sales proposal might also result in blanket taxation of university presses, a result that we do not believe was intended and that certainly is not justified. Similarly, the proposal could lead to taxation of books or course-related supplies sold in connection with extension education courses taught in the workplace or in satellite learning centers. Again, such a result could only be unintended -- but the absence of malice would be cold comfort if the tax were statutorily compelled.

The higher education community believes that, if some campus bookstores sell items which should be subject to the unrelated business income tax, administrative action based on present law -- which is already capable of supporting determinations comparable to those reflected in the proposal -- would be far more effective than any statutory remedy. If the Subcommittee decides that legislation is nonetheless necessary, we believe that it is extremely important that representatives of the higher education community be allowed to participate in the formulation of the precise statutory standard, so that the law as enacted actually reflects what the Congress intended. The few examples cited above indicate how likely it is that an apparently reasonable standard will, in a context such as this, produce wholly unreasonable results. We believe that the risk is too great to be accepted.

Treatment of Taxable Subsidiaries

As we have indicated in prior submissions, we would not oppose changes in the control definition for purposes of determining the taxation of certain transfers from controlled taxable subsidiaries to their exempt parents, provided that such changes are prospective only.

However, we do not support the proposal to aggregate the activities of taxable subsidiaries with the activity of an exempt parent for purposes of determining whether the parent's operations are primarily charitable. In cases where the officers and directors of an exempt organization actually manage the daily activities of a subsidiary, thus diverting administrative or other resources of the parent to the taxable business, present law now allows for aggregation, and we agree that in such cases it is appropriate. Where a taxable business is not only separately incorporated but also separately managed, however, there is no comparable justification for aggregation. Indeed to the contrary, we believe that creation of separately operated taxable subsidiaries is a reasonable and desirable response to the issues of competition and tax-exempt enterprise with which this Subcommittee has been concerned.

Although its purpose is not articulated, it appears that this proposal is responsive to concerns of the Internal Revenue Service that the transfer of value or of tax-favored resources in the creation and operation of a taxable subsidiary may not in some cases be correctly reflected in taxable income. Like the proposal concerning the allocation of deductions, however, this proposal contravenes basic principles of taxation (in that case the determination of net income, in this case the respect for valid corporate structures), simply in order to resolve a tax accounting issue which would be better settled by regulation.

We are also troubled by the proposed requirement that a controlled subsidiary's income could be no less than the unrelated business taxable income would have been if the unrelated business had been conducted within the exempt parent. This requirement alone would probably double the legal and accounting expenditures of some charitable and educational organizations. It is flawed in very obvious, practical ways -- for example, the subsidiary would not be able to deduct payments of rents, royalties or interest to the exempt parent, despite the fact that under the controlled subsidiary rules the parent would be taking such amounts into income. Moreover, the unrelated business taxable income which the exempt parent might have reported is a purely hypothetical figure which would vary depending on the efficiency of resource allocations, economies of scale and other factors that could not be quantified in the abstract. By allowing a calculation that by definition could never be precise and could never be confirmed to control the taxable income of a separately operated subsidiary, this proposal would increase rather than reduce the potential for controversy.

Like the proposal on allocation of deductions, this proposal is an artificial attempt to resolve by statute what seem to be problems of tax accounting, and to do so by annulling in the unrelated business income context what are otherwise generally applicable principles of income taxation.

Advertising Income

The discussion options would tax all advertising income, and limit deductions to direct advertising costs. Taxation of advertising income would have a direct impact on the operation of student newspapers and radio stations. In all likelihood it would limit the publication of programs for campus athletic and cultural events, since the costs of such programs, and on occasion even a part of the cost of such events, are typically paid with income from advertising. Curtailment of such student programs does not seem to be a reasonable response to whatever competition complaints may have come from publishers. If a specific provision on advertising is adopted, we urge the Subcommittee to provide an exception to the tax for any advertising in educational or student-run programs or in campus publications.

We also question the appropriateness of limiting deductions to direct advertising costs. Present law provides that if the publication as a whole is operated at a loss (because readership costs exceed readership income), tax should not be imposed on advertising income in excess of direct advertising costs. The purpose of this rule was to equalize the treatment of exempt organization publications and commercial publications, since a commercial magazine does not pay tax on advertising income if it operates at an overall loss. This seems to be a fair rule and a sensible result. We understand that the Internal Revenue Service may believe that because of the particular rules for calculating readership income or loss set out in its regulations, a few organizations may not be paying tax on what appears to be substantial advertising income. Again, however, an essentially administrative matter -- here a simple drafting issue in connection with the regulations -- has become the basis for a departure from the structure of the unrelated business income tax. Again, we do not believe that the result is a necessary or appropriate one.

Need for Clarification

The issues addressed above are the major substantive concerns of the higher education community with the discussion options. There are, however, a few areas in which we believe that some clarification of the proposed changes is necessary.

(i) Testing

We agree with the proposed exceptions to taxation of routine testing income, which are responsive to points made in our earlier submissions. We believe, however, that if a specific provision on testing is included in the statute, it should specify that any testing activities incident to a research project would fall under the research exception. Because of the importance of this issue it may in fact be advisable to provide in the statute a basis to distinguish research with its ancillary and incidental activities from ordinary testing. We believe that we can formulate such a statutory distinction, and we will be discussing that issue with Subcommittee staff.

We also assume that various kinds of testing performed by a university hospital in connection with its teaching or medical functions would be evaluated under the "substantially related" standard without respect to the specific provision on routine testing. Again, however, because of the importance of the issue we urge the Subcommittee to clarify this point by specific statutory reference.

(ii) Travel Services

We agree with and appreciate the proposal that curriculum-related travel should retain its tax-exempt status. We believe, however, that the exception should be expanded to include such things as student exchange programs. We also believe that travel services provided by a college or university to its faculty and administrators in connection with academic, scholarly or administrative activities are unlikely to result in competition (since most of these services are provided in conjunction with travel agencies). Such services, however, do result in cost-savings which can be very significant. We ask, therefore, that the exception from the general taxation of travel be expanded to include this limited category of travel service activities.

(iii) Medical and Pharmaceutical Products

We assume that the tax would not be applied to income from selling or otherwise providing any medical, pharmaceutical, or laboratory products to the extent that such products play a direct role in the educational curriculum, or are used in serving the health needs of the campus community. We believe, however, that if a specific provision applying to medical and pharmaceutical products is added to the statute, this exception should be made explicit.

Members of the higher education community will continue to be available to the Subcommittee and its staff as you pursue your deliberations on this important issue. We appreciate your attention to our efforts and concerns.

Yours truly,

Sheldon Elliot Steinbach

Sheldon Elliot Steinbach

STATEMENT OF THE

AMERICAN DENTAL ASSOCIATION

Mr. Chairman, Members of the Committee, I am Dr. William Allen, Associate Executive Director, American Dental Association, and Director of the ADA's Washington Office. I am submitting this statement on behalf of the Association's 145,000 member-dentists. The Association is a tax-exempt organization under Internal Revenue Code Section 501 (c)(6).

The Association wishes to commend the Subcommittee for seeking public comments on options regarding unrelated business income tax, prior to its formulating recommendations to the full committee. We hope that the responses will contribute to the development of a sound informational base against which the appropriateness of current law may be measured.

In our review of comments and testimony on this issue, submitted in connection with the Subcommittee's hearings last summer, we were struck by the lack of comprehensive data on the effects of tax-exempt organizations' income-producing activities on competition. Complaints to the Subcommittee that tax-exempt organizations have exercised an unfair competitive advantage were based either on individual instances of alleged unfairness or generalized unsubstantiated allegations.

Should the information being sought currently prove no more substantive, the Association believes the Subcommittee should recommend that a study be initiated as soon as possible to determine the extent to which income-producing activities of tax-exempt organizations compete with activities of taxable businesses and the percentage of such activities that have been determined to be unrelated to the organizations' tax-exempt purposes, and therefore subject to taxation. In suggesting this study, the Association well recognizes that such comprehensive data will be difficult to assemble and will be done only at considerable expense. But, as the Subcommittee knows, the unrelated business income tax law is a matter of vital concern to tax-exempt organizations, as well as to some segments of the business community. We believe this law has served the public well. Changes in it should be made only on the basis of documented need.

We also believe that a greater investment should be made in enforcement activities in the tax-exempt sector. Better guidance efforts by the Treasury Department to assure that compliance requirements are fully understood would be a necessary adjunct to improved enforcement. This is especially true of exempt organizations without ready access to legal and tax counseling services.

Indeed, in the Association's view, it would be imprudent to change current law without first determining the extent to which more rigorous enforcement and improved informational services would resolve "unfair-advantage" issues. We expect that the effect would be positive and substantial. It is enlightening to note the instances, previously reported to the Subcommittee, in which the complained of activity was one that is taxable under current law, and which would have been taxed from the outset if the law were properly understood and being properly enforced.

Additionally, the Association wishes to emphasize its support for retention of the "substantially related" test in its present form. This measure allows tax exempt organizations a reasonable degree of flexibility in raising funds to support their charitable and educational endeavors: research, educational seminars and public information campaigns. In the health care disciplines, these are activities that clearly benefit the public and the health professionals who treat the public. If not carried out by tax-exempt organizations, these activities would have to be conducted by the government or abandoned. Either eventuality would not serve the public's fiscal or health interests.

Regarding royalties, and indeed all passive income, the Association believes that the original observation of the Congress remains valid:

> "Dividends, interest, royalties, most rents, capital gains and losses and similar items are excluded from the base of the tax on unrelated income because your committee believes that they are passive in character and are not likely to result in serious competition for taxable businesses having similar income." (S. Rep. No. 2375, 81st Cong. 2d. Sess. (1950) at 30-31.)

Congress recognized that owners of intangibles do not compete with taxable ventures with respect to the sale of assets for future royalty payments. The statute excludes all royalties, whether measured by production or by gross taxable income from the property. Congress specifically did not narrow this definition since royalties, from whatever source derived, do not compete with for-profit companies and are purely passive income.

Finally, the Association was pleased to see consideration being given to increasing the UBIT deduction for smaller tax-exempt organizations. As discussed in our letter of July 17, 1987 to the Subcommittee Chairman, such a change would allow department resources to be invested in more productive enforcement activities, which, increasingly, we see as the key to resolving concerns about UBIT in the business sector and the Congress.

The Association appreciates the Subcommittee's attention to its comments.

AMERICAN FARM BUREAU FEDERATION
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April 15, 1988

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
House Committee on Ways and Means
Washington, DC 20515

Dear Representative Pickle:

The American Farm Bureau Federation is the nation's largest general farm organization. Farm Bureau is organized in 2,800 counties throughout 49 states and Puerto Rico and is tax exempt under Internal Revenue Code Section 501(c)(5).

As a tax exempt organization, Farm Bureau is interested in the Subcommittee's actions with regard to the unrelated business income tax (UBIT). While it is possible that several of the discussion options listed in the Subcommittee's March 31 press release will affect Farm Bureau, there are three issues in particular to which we call your attention.

I. REPLACEMENT OF THE "SUBSTANTIALLY RELATED" TEST

Under Internal Revenue Code (IRC) Section 513, an activity of an exempt organization will not be considered taxable as an unrelated business activity if the activity is "substantially related" to the organization's exempt purpose. The replacement or alteration of the "substantially related" test has been opened for discussion by the Subcommittee. Among the changes proposed is that the "substantially related" test either be replaced with a "directly related" test or that the substantially related test be retained but that to the extent that the activity in question is essentially commercial in nature such activity would be taxable. The Subcommittee has before it a limited list of activities it deems might be essentially commercial.

It is our view that any change which would replace the "substantially related" test with a more restrictive one, or which would restrict the present application of the "substantially related" test, is both unwarranted and unnecessary. Our view is based upon three points:

(1) As presently interpreted by the Courts and the Internal Revenue Service, the "substantially related" test is significantly restrictive. It is our view that the "substantially related" test, as it has been applied by the Courts and Internal Revenue Service, may already be too restrictive;

(2) Any alteration of the "substantially related" test as is currently interpreted would risk subjecting to taxation activities which clearly contribute importantly to an organization's exempt purpose; and

(3) A "directly related" test could subject to taxation substantially all activities of membership organizations except for the collection of membership dues.

The "substantially related" test, as it is presently defined under Regulation Section 1.513-1(d), requires the presence of a substantial causal relationship to the achievement of an exempt purpose in order for a given trade or business activity to be considered as "related" to an exempt activity.

In defining the requisite causal relationship, Regulation Section 1.513-1(d)(2) provides the following:

> "Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business."

Hence, the existence of a causal relationship is essentially determined by whether the trade or business in question contributes importantly to an organization's purpose.

Many activities which should not be subject to taxation currently are subject to tax because Treasury has been overly restrictive in its interpretation of which activities contribute importantly to an organization's exempt purpose. For instance, Revenue Ruling 69-51, 1969-1 C.B. 159 ruled that the sale of cattle on behalf of its members on a commission basis, by an agricultural organization exempt under Section 501(c)(5), whose purpose is to promote the betterment of conditions of breeders of a specified breed of cattle and to improve the breed generally, did not contribute to the organization's exempt functions. However, Private Letter Ruling 8038001 ruled that the sale of hogs on a commission basis by a similar Section 501(c)(5) organization was substantially related where the sales took place at the organization's meetings that involved the showing and judging of hogs, where the subsequent sale was a prerequisite to entry in the show, and where only prize winning hogs were sold. We believe that the distinctions in these rulings are without substance. Furthermore, we believe that the published ruling applied the substantially related test in a too restrictive manner.

In adopting a more restrictive test, Congress would begin taxing activities which contribute importantly to an organization's exempt purpose. It is our view that it is inappropriate to subject such activities to taxation. For if in the opinion of Congress, the organization's activities were to provide insufficient benefit to the general public, presumably Congress would not have granted the organization exempt status. Once Congress has determined that an organization and its activities warrant exempt status, it would appear self-defeating to tax those activities which contribute importantly to the organization's exempt purpose. We believe that Congress has never intended to subject to taxation activities which contribute importantly to an organization's exempt purpose. Therefore, we respectfully ask that Congress not adopt a more restrictive test for determining whether an exempt organization's activities should be subject to taxation.

Even if Congress were to decide that a more restrictive test were appropriate, we believe that the replacement of the "substantially related" test with a "directly related" standard would be unwarranted. The use of the term "directly related" implies that in order to satisfy the test a trade or business activity would virtually have to be directly achieving the exempt purpose itself. We feel that such a test would be too constrictive. There exist many activities which could be either incidental or necessary for the achievement of an organization's exempt purpose, but which would not in and of themselves be directly achieving the purpose for which the organization's exemption was granted. For example, many membership organizations provide collateral services to their members which greatly benefit the public. It appears that such activities would be excluded from a related business exemption under a "directly related" test. If an activity of a membership organization were required to be directly related to the organization's exempt purposes, it is conceivable that only the dues income of such membership organizations would constitute income "directly related" to the organization's exempt purpose. Congress clearly does not intend such a result. Therefore, we request that Congress not adopt a "directly related" standard.

II. REVISED TAX TREATMENT OF ROYALTY INCOME

The original intent behind the laws pertaining to the taxation of an exempt organization's unrelated business income focused on the concept of unfair competition. IRC Section 512 et. seq. relates to the taxation of an exempt organization's unrelated business income. When the predecessor of IRC Section 512 was enacted in 1950, Congress stated:

> "The problem at which the tax on unrelated business income is directed is primarily that of unfair competition. The tax-free status of Section 101 organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes." (S. Rep. No. 2375, 81st Cong. 2nd Sess. (1950) at 28)

The receipt of royalty, along with other investment income, was specifically exempted from the unrelated business tax. The prior legislators' position on this issue was as follows:

> "Dividends, interest, royalties, most rents, capital gains and losses and similar items are excluded from the base of the tax on unrelated income because your committee believes that they are "passive" in character and are not likely to result in serious completion for taxable businesses having similar income." (S. Rep. No. 2375, 81st Cong. 2nd Sess. (1950) at 30-31)

In effect these legislators exempted the not-for-profit owners of intangibles because they do not compete with taxable ventures. We do not feel that any change in this treatment of exempt royalties is warranted. The statute excludes "all royalties" whether measured by production or by gross or taxable income from the property. The prior legislators specifically did not narrow this definition because royalties from whatever source derived do not compete with for-profit companies and are purely passive income.

An organization does not actively conduct a business when it sells its intangible property and shares in the royalty payments. When an exempt entity obtains royalty rights, a potential active business venture of an exempt organization has been transferred to a new owner, and all future business risk, gains, and operating costs will be incurred by the new owner. Since the exempt organization no longer participates in an active trade or business following transfer of intangible rights, the royalty payments it receives should not be taxable as unrelated business income.

Therefore, because of the passive nature of all royalty income, we believe that the current exemption for "all royalty" receipts is proper. Furthermore, the provision for applying Unrelated Business Income Tax (UBIT) to royalties measured by net or taxable income derived from the property, if enacted, will be in direct opposition to the original intent of Congress when the UBIT provisions were first enacted in 1950. We believe the reasoning behind Congress' original exemption for royalty income is valid today.

The additional proposal that UBIT be applied to royalties when an exempt organization has created the royalty property, or has performed substantial services or incurred substantial costs with respect to developing or marketing the property, is unnecessary. As interpreted by the Courts and the Internal Revenue Service in numerous rulings, the inherent passive nature of royalty income can be overridden when an exempt organization expends substantial resources in developing or marketing such a property. Where an exempt organization has performed substantial services in conjunction with the receipt of royalty income, the Courts and the Internal Revenue Service have always recharacterized the royalty payments as receipts for services. Receipts for services are subject to the tax on unrelated business income where the services performed are not substantially related to the organization's exempt purpose. We feel that the position the Courts have taken is well-known and well-serving of the public interest with respect to exempt organizations. In light of this, we feel that any further refining of the definition of taxable royalty income for exempt organizations is unwarranted, and we respectfully request that this proposal not be adopted.

III. CHANGES TO ALLOCATION RULES

Also under consideration by Congress are Treasury's proposed changes of the rules pertaining to the allocation of operating costs for dual use facilities. A dual use facility is one where the assets are used for both charitable and non-charitable purposes. It has been proposed that only the direct operating costs allocable to the non-charitable activity will be deductible by the non-charitable activity. Certain indirect operating costs, such as depreciation and general overhead which currently are allocable between charitable and non-charitable uses, would not be deductible from income derived from the non-charitable activity under the new allocation rules.

If a non-charitable activity is exploitative of the goodwill generated by an exempt activity, the deductibility of indirect costs should be limited, and it is. In such a situation, Regulation Section 1.512(a)-1(d)(1) limits the allocation of indirect costs to the non-charitable activity. However, where the non-charitable activity is not exploitative of the goodwill generated by an exempt activity, the non-charitable activity should be allowed the same benefits and deductions as other for-profit entities. To allow otherwise would put the non-charitable activities of exempt organizations at a competitive disadvantage in relation to their for-profit counterparts. In our view, such a concept is counter to the purpose and justification behind the tax on unrelated business activities, as it was originally enacted by Congress in 1950.

Under the Revenue Act of 1950, Congress provided for the consolidation of an exempt organization's income from all its various unrelated trade or business activities, stating that:

> "To do otherwise would deny the organizations the benefit now enjoyed by ordinary corporations of offsetting the losses on one venture against the gains on another." (S. Rep. No. 2375, 81st Cong. 2nd Sess. (1950) at 28)

Thus, Congress established that the taxable unrelated business income of exempt organizations should not be denied those benefits that are granted to the taxable income of ordinary corporations. In keeping with this, exempt organizations should certainly not be denied the benefits received by taxable entities through the deductions allowed for their overhead costs and depreciation expenses. The enactment of this allocation rule will not be serving to create a competitive parity within the context of the 1950 Act. Rather, it will serve to create a substantial disparity. If we are to consider unrelated business income as business income at all, then certainly we should afford tax-exempt organizations those same ordinary and necessary business expenses that are granted to their taxable counterparts. Therefore, we respectfully request that Congress not adopt this proposal.

Thank you for the consideration of Farm Bureau's comments.

Sincerely,

John C Datt

John C. Datt
Executive Director
Washington Office

American Foundation for the Blind
Helen Keller's Cause in the U.S.

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April 15, 1988

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The Honorable J.J. Pickle
U.S. House of Representatives
242 Cannon House Office Building
Washington, DC 20515

Dear Congressman Pickle,

On behalf of the American Foundation for the Blind (AFB), I would like to express my concerns involving the new proposal from the House Ways and Means Committee to tax income producing activities of non-profit organization.

The American Foundation for the Blind is a 501(C)3 nonprofit national organization established in 1921 to help improve the standards of service for blind and visually impaired people. AFB provides direct assistance and referral services in partnership with over 1000 specialized agencies, schools, universities, senior centers, and businesses nationwide. We are headquartered in New York City, with regional centers in Atlanta, Chicago, Dallas, San Francisco, New York and Washington, D.C.

Our analysis of the proposal has raised serious concern, particularly in the areas of the following; fund-raising events; catalogue and other mail or phone order sales; and the requested IRS study pertinent to taxing exchanges and rentals of donor lists among section 501 (C) (3) organizations.

Fund-Raising Events
On an annual basis the AFB conducts the Corporation of the Year Award in New York City, to recognize the contribution of corporate America in helping blind and visually impaired persons lead full and independent lives. Tickets to this event are sold a to variety of persons and companies, ultimately providing, AFB with a modest profit. The services provided at the events location, a major New York hotel, eg. room rental, food costs, decorations, as well as the invitations are paid for by AFB. Taxing of such would significantly reduce the profit, and depending upon the proposed changes may ultimately force us to cancel the event.

In our regional centers across the United States, similar events are also carried out. In some cases we have been fortunate to have goods and services donated, however, in many instances, this has not been the case.

Profits from all such ventures are used to maintain, strengthen, and increase our programs and services.

Improving the quality of life for blind and visually impaired Americans in cooperation with over 1,000 agencies and schools nationwide.

Catalogue and Other Mail or Phone Order Sales
AFB adapts, evaluates, manufactures and sells (both in our New York showroom and in a mail order catalogue) special aids and products to help blind and visually impaired people live independently.

This includes as health care products, household items, mobility aids, tools, watches, and a variety of other devices, specially designed for blind persons.

The majority of our sales take place through our national mail order catalogue. Items are sold at cost, and frequently require AFB to subsidize the program. We do hope that at some point in the future, this service will make at least a marginal profit, so that funds can be redirected to the development and/or adaptation of new products for blind persons. Taxing of such would greatly reduce the scope and distribution to blind persons nationwide.

AFB is the major U.S. publisher of educational textbooks, pamphlets, periodicals, and other books concerned with blindness and visual impairment. We offer paid subscription of works as such as the monthly Journal of Visual Impairment and Blindness, the leading professional journal in the field as well as, other newsletters. Although sales do take place in our New York showroom, the bulk are carried out through the mail order catalogue. Like our adaptive aids and appliances, AFB subsidizes the production costs of all books, pamphlets, to keep costs as low as possible for professionals and blind and visually impaired persons. Our overhead-staff time in the writing, production, and graphic design, are not factored into the ultimate price of the publication.

Again, if taxes were imposed upon such, the purchasing price would be greatly increased and ultimately too costly for many of our regular customer, particularly blind and visually impaired persons.

IRS Study-Exchange and Rental of Donor Lists
In recommending this study, serious thought should be given to what alternatives are available for nonprofits to attract and secure new donors. AFB routinely exchanges and rents lists of donors to replenish and expand upon our current donor base. Each year we loose a significant number of donors due to their inability to renew contributions because of changing financial status, by a lack of interest in the organization, death, as well as a variety of other variables.

It should also be noted that the list brokerage industry is self-regulated and follows strict ethical guidelines about how specific names can and cannot be utilized. When implementing the proposed study, I hope all these factors will be taken into consideration.

I strongly believe that the cases we have presented are all "substantially related" to accomplish AFB's exempt purpose, by providing income to carry out vital programs and services for blind Americans. As delineated in the proposed new taxes, some authorities could view this a "inherently commercial" rather than charitable in nature. This would force AFB to take major steps in restructuring our fund raising and mail order activities which most likely would cause a reduction of services to blind and visually impaired persons.

I thank you for the opportunity to comment on the work of the subcommittee. Please feel free to contact my office directly for additional information or documentation.

Sincerely,

William F. Gallagher

William F. Gallagher, MSW
Executive Director

Comments on Discussion Options on the Unrelated Business Income Tax

Dr. Athelstan F. Spilhaus, Jr.
Executive Director
American Geophysical Union

The Subcommittee's discussion options all seem aimed at expanding the potential for inequitable, if not truly discriminatory, taxation of charitable organizations. For the past 18 years I have struggled, as the Executive Director of a learned society, to find ways to maximize the impact of government and private dollars on the advancement of science. In doing this kind of work the American Geophysical Union and many other of scientific and educational organizations help to relieve the burden of government. They provide a healthy diversity of approaches to the problems that face our nation economically, militarily, and socially. In reviewing the proposed discussion options, I wondered whether you have considered why we have charitable organizations and how we can strengthen them, while assuring that the legitimate favorable tax treatment they receive is not misused to shelter unrelated business operations. Such unrelated business operations should be treated exactly as if they were commercial activities. I appeal to you to consider the overall interest of the country and not the narrow objectives of raising tax revenues or of punishing those few not-for-profits that are misusing their status.

I am additionally concerned that in general the proposals in your discussion options serve to further complicate the tax picture for charitable organizations. Many of these organizations are small and all of them would like to keep their overheads and administrative costs at an absolute minimum so that their meager funds can be used for the public good.

An unfortunate theme that was introduced in the 1969 Tax Reform Act and is perpetuated here is the punitive taxation of charities on their "unrelated" activities. If the "inherently commercial" activities of charitable organizations are to be taxed, surely they should be taxed on exactly the same basis as for commercial organizations. Without having thought about it in great depth, I suggest that the simpliest procedure would be to simply divide each charitable organization into two parts, one consisting of its activities that are directly related to its exempt purposes (or substantially related) and the other consisting of its remaining activities. The second part could be treated just like a corporation even to the extent of filing the corporate income tax returns we now have rather than creating new structures and new forms. Allocation of management and overhead costs between these two subentities must be allowed; but, of course, it would not be appropriate to charge administrative costs related to carrying on charitable activities to the "commercial side". I believe it is unreasonably complex, and indeed probably punitive, to require that each taxable activity of a charitable organization be treated separately. What would the proprietor of a dry cleaning and laundry plant say if he were taxed separately on the drycleaning and laundry aspects of his operation, or a movie theater owner if he were taxed separately on his popcorn and candy sales? This approach, which was taken in the regulations implementing the 1969 law, would be extended by the options you are now considering. It has the potential for being grossly unfair to charitable organizations and the potential for doing serious damage to this important sector of our society.

I am not well enough versed in the legal aspects of the tax law to discuss many of your proposals in detail but I would like to make some comments as a pragmatic manager (but somewhat idealistic scientist) who must deal with these issues on a day to day and tax year to tax year basis.

As far as the "substantially related" test is concerned, I don't care if you replace it with a "directly related" test so long as any taxation of "unrelated" activities is on a fair basis and so long as it is quite clear what "directly related" means. The activities of scientific, educational and other charitable organizations that are directly related to their exempt purposes are so diverse that there may be considerable difficulty in arriving at a consensus with the IRS on what is directly related. Should you change the test, I hope you will define what you intend clearly in the legislative record and that it will be consistent with the vision of a strong charitable component of the private sector.

As long as an "income producing activity" can be defined in a reasonably broad sense, I have no problem with looking at each activity to determine whether it is in fact "tax exempt". Difficulty arises when looking at examples that you have treated many times before, advertising in publications and exhibitions held in connection with meetings. In both these cases, the income producing activity has been very narrowly defined. If we publish a scientific journal that is directly related to the tax exempt purposes of our organization and do not accept advertising, there are no questions. When we accept advertising for that publication, the advertising activity alone is treated as taxable and only through a series of funny formulas am I permitted to make some allocation of the other costs. This is a ridiculous conclusion. It is a pubication that supports the advertising. Advertisers would not use it if it were not for the publication itself and if the publisher chooses to accept advertising, then it should be possible to treat that entire entity in the same way as it would be in the commercial environment. A tax exempt organization should have the option of choosing where to divide a project so long as all taxable activities are on the taxed side and unrelated distinctly exempt activities are on the other side. When an organization has done so, all attributable income and expense are unequivocally one side of the line or the other; arguments over inequitable formulas disappear.

I can see some considerable difficulties for the American Geophysical Union in the A-L list of activities that the Subcommittee seems to consider to be "inherently commercial". The very first one which suggests applying UBIT to income from mail and phone orders and off-premise sales would have the effect of taxing our primary exempt activity, the publication of science. Learned societies are essentially communication networks among scholars, and publications and meetings are the two ways that scholars choose to communicate. Prices would have to go up because of the taxes and because of the added administration and thus dissemination would go down and the public would be hurt. If this rule applied to journal subscriptions, it would probably not make sense for any scientific or learned society to continue to publish in the tax exempt environment as we do today. America leads the world in scientific publishing because of its societies. That lead could disappear and with it much of the infrastructure that supports the individual scientist.

Another specific that caught my eye was the allowance against advertising income of only direct advertising cost. This is clearly unfair, placing a substantial extra burden on the community of charitable organizations as compared with the commercial ones.

My personal opinion is that trying to enumerate such a list of activities and to spell out in detail how each will be dealt with would be a great mistake. For one organization some of the activities that you view as "inherently commercial" are, in fact, not commercial at all but are the essense of why they exist and why they have tax exempt status. For other organizations they are clearly commercial income producers. I sincerely hope you will not further that approach but will in fact consider backing up to the pre-1969 days when each organization and activity stood on its own feet.

The proposed treatment of royalty income may contain similar traps for some organizations. Royalties from the sale of publication rights may be a way of disseminating information to the third world or a way of broadening the use of scientific and medical information and thus, may be directly related to the organization's exempt purpose. Royalty income should not be automatically taxable.

Perhaps I am not sophisticated enough to understand the need for having a different treatment of corporations controlled by exempt organizations from the treatment of any other corporation. If our tax laws for corporations are adequate, then it should not matter; it should make no difference whether a not-for-profit owns a sizeable fraction of it or even enough to control it so long as the transfers of funds between the two organizations are legal. Why introduce extra complexity and again the image, if not the reality, of inequitable treatment of charitable organizations. Why not just be sure that the enforcement aimed at the abusers is effective.

The section on allocation rules was the one that really upset me. It is clearly unfair to disallow deductions for the general overhead of an organization or for depreciation that would be allowable to a taxable entity. If a facility is used one half for taxable purposes and one half for tax exempt purposes, surely fairness demands that one half the depreciation on that facility be allocated to the taxable side and similarly, one half the time of the building manager and the accounting effort and the personnel department costs that go into that facility have to be allocable. To do otherwise is to place the burden of a taxable activity on a charitable one and thus ultimately to force charitable organizations out of "unrelated" activities. Is that the intended policy? If so, it should be put on the table honestly and thoroughly discussed. I believe you would find it undesirable, and probably impractical to entirely segregate the two. Such a separation would leave charitable organizations emasculated because of natural affinities of certain kinds of charitable activities with certain of what you apparently feel are "inherently commercial" activities. If we own our headquarters building and currently only use half of it and rent out the other half, the general overhead associated with managing that building and the depreciation of that building would have to be born entirely by funds that were intended for charitable purposes. Yet we cannot afford not to rent out the empty space. Do you intend the renters to be subsidized by the absorbtion of overhead by the charity? I doubt it.

With respect to tax information and administration I certainly hate to see expansion of the Form 990T. As I stated at the outset of these comments, I prefer a different alternative. That would be to provide as detailed reporting as required on the Form 990 and then to all require organizations with "unrelated activities" to report them as if they were in a separate corporation on standard corporate income tax returns.

In summary it appears to me that your proposals will result in more of the same -- increased complexity, increased bureaucracy, and increased administrative costs. They will lead to a reduced productivity and effectiveness in our charitable sector and thus, will damage our society. I urge you to take a fresh approach by better defining your objectives and then by legislating some broad principles that will prove equitable to all concerned and will effectively advance the nation's interests.

Thank you for the opportunity to submit this statement.

American Healthcare Institute
Affiliated with American Healthcare Systems

James L. Scott
President

April 15, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth HOB
Washington, DC 20515

Dear Mr. Leonard:

This is in response to an invitation from the Subcommittee on Oversight, Committee on Ways and Means, to comment on discussion options relating to the unrelated business income tax (UBIT) outlined in the Subcommittee's press release of March 31, 1988. The American Healthcare Institute is appreciative of this opportunity to offer its comments on the discussion options.

The American Healthcare Institute represents a national network of 34 voluntary, not-for-profit health systems. These systems, working to provide the American people with high quality health care at an affordable price, comprise the largest network of not-for-profit hospitals in the world.

In previous testimony before the Subcommittee, we clearly stated that the member systems of the American Healthcare Institute support the underlying rationale for the imposition of an unrelated business tax. UBIT was not intended either to adversely affect the tax-exempt status of qualified organizations or to preclude such organizations from engaging in any activities they may legally pursue. It is intended to impose taxes on unrelated commercial activities of these basically not-for-profit enterprises that are comparable to those imposed on taxable entities.

We do, however, have a number of concerns about some of the proposals outlined in the Subcommittee press release dealing with the following matters:

1. "Substantially Related" Test. We are concerned about the elimination of the "substantially related" test and its replacement with a "directly related" test. We recognize that there have been some questions about the appropriateness of the characterization of certain activities of organizations as "substantially related" to the accomplishment of an exempt organization's purposes. We are concerned that the application of some new, untried test of "relatedness" would change the current rules in an unknown and potentially damaging way. It is unpredictable how the treatment of activities of not-for-profit hospitals that have been found to be substantially related to their tax-exempt purposes would change. AHI believes that more effective application of the existing "substantially related" test is preferable to the development of some new standard because the latter would not involve a reconsideration of the existing rules which have been generally reasonable in their effect.

2. Application of UBIT to Gift Shops, Medical Equipment, Laboratory Testing and Pharmaceuticals, Etc. The American Healthcare Institute strongly opposes the options that would apply UBIT to hospital gift shops, to all sales or rental income of medical equipment and devices, laboratory testing and pharmaceutical drugs and goods (with certain exceptions). In the case of gift shops, exceptions would be allowed for articles generally used by or for hospital inpatients. In the case of medical equipment, laboratory testing and pharmaceuticals, exceptions would apply in the case of inpatients, continuous care outpatients, or where items are not available in an immediate geographic area.

The purpose of these activities when provided by not-for-profit hospitals is to serve patients. Establishing new, complex rules to determine whether specific transactions are related to specific kinds of patients (e.g., the patient is an inpatient, the patient is a continuous-care outpatient , etc.) is unwarranted and unneeded, yet imposes additional administrative burdens on hospitals and the government. In order to comply with the proposed changes hospitals would apparently be required to classify their patients using a new as yet untested definition to determine what IRS rule would apply to each of them and the IRS would be required to police the correctness of the classifications. The Internal Revenue Service has already developed rules that distinguish between sales and services to patients versus services to non-patients. The existing rules are well understood and for the most part are working well. AHI strongly objects to any changes in the rules that would differentiate among patients served by hospitals.

Hospitals consider their function to be to serve the health care needs of the community, including some who cannot pay the full cost. The proposal would seem to inhibit their performance of this function for some types of patients who might be deprived of access to care even when the service was available to most of the community.

3. Taxation of For-Profit Subsidiaries. One of the proposed options would provide that a controlled taxable subsidiary's income could be no less than its unrelated business income would have been if the income-producing activity has been carried on directly by the exempt parent organization. AHI strongly objects to this proposal. There are many sound business, mission, and legal reasons why a not-for-profit hospital should conduct certain activities in a taxable subsidiary. Tax-exempt organizations should not be placed at a tax disadvantage as a result of making these decisions.

In effect, the government would essentially be collapsing the corporate structure for tax purposes and in a manner unfair to tax-exempt organizations.

4. Allocation Rules. One of the options presented would allow a deduction against unrelated business income for a proportionate share of the direct operating cost of a facility, but not allow a deduction for the share of the general overhead of the organization or for depreciation. AHI opposes this change in allocation rules. We believe that tax-exempt organizations should not be placed at a tax disadvantage in the operation of a for-profit subsidiary. General overhead and depreciation are recognized as legitimate, deductible costs of doing business for all organizations. It is unfair to deny these deductions to an entity solely because its parent is a tax-exempt organization. AHI believes that facilities of exempt organizations which are used both to carry on exempt activities and unrelated business activities should continue to be allocated between the two uses on a reasonable basis.

The AHI appreciates the Subcommittee's consideration of our views.

Sincerely yours,

James L. Scott

James L. Scott

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April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Sir:

At last something is being done against our competition, the nonprofit business. Yes, it is a business or a wolf in sheep's clothing.

We wish to say thanks for your concern on our behalf and for your time. For too long, we in the hearing aid industry have said nothing but we cry ENOUGH! Please apply UBIT to ALL hearing aid sales income of nonprofits. Also, we would like to see the "convenience" exemption repealed or recognize patients as inpatients only.

We have been in business 15 years and would like to continue. We need your help.

Sincerely,

McRae B. Powers, B. C.

Comments of the
American Heart Association

The American Heart Association welcomes the opportunity to comment on the unrelated business income tax (UBIT) discussion options recently put forth by the House Ways and Means Subcommittee on Oversight.

Testimony presented to the Oversight Subcommittee in June 1987 detailed the history of the American Heart Association and the important role we have played in terms of combatting this nation's number one killer: cardiovascular disease. Time and space limitations do not permit a repetition of these important facts. However, worth noting are recently released statistics, showing a dramatic increase in the American Heart Association's support of research throughout the 1980's.

According to these statistics, the American Heart Association has more than doubled its investment in heart and blood vessel research since 1980 from $26.7 million in 1980 to $60.1 million in the fiscal year that will end June 30, 1988. The research outlay of $60.1 million for fiscal year 1987-88 is 85 times greater than the $700,000 spent by the fledgling Association during 1949, the first year the American Heart Association mounted a national program of heart research support. Since 1949, the Association and its state and local components have invested more than $691 million in research -- a financial commitment to the study of cardiovascular disease second only to that of the federally sponsored National Heart, Lung and Blood Institute.

In 1987-88, national American Heart Association research programs are supporting the work of 786 cardiovascular scientists at universities, medical schools and research centers across the nation. These include basic and clinical researchers who are American Heart Association established investigators, career investigators, clinician-scientists, grant-in-aid recipients and medical student research fellows. In general, awards made by our organization include salary support, project support, or a combination of the two, and are designed to achieve three objectives: to attract and encourage promising scientists to make cardiovascular research their career; to encourage and fund high-quality research projects; and to originate and test new programs that fill gaps in existing program offerings and that can become models for those other agencies.

The results of these research efforts have become the cornorstone for the American Heart Association's professional and public education programs. Research results are often first made available through our professional education programs, which include the gathering of scientists and researchers at our annual Scientific Sessions for the presentation of abstracts, the publication of nine scientific journals, and the cosponsoring of 12 postgraduate courses. Research results are transmitted to the general public through several community education programs. In 1986, nearly 700,000 employees participated in our Heart At Work program, 400,000 pre-school and grade school students participated in Heart Treasure Chest, 300,000 teenagers participated in the Save-A-Sweetheart program, and 95 million Americans shopped at grocery stores participating in the American Heart Association annual food festival.

We believe that the nation is already reaping the benefits of our research and public education efforts. As the American Heart Association's contributions to research and public education have gone up, the death toll recorded by cardiovascular disease has gone down. Between 1976 and 1985, the death rate from coronary heart disease declined 23.6 percent, and the stroke death rate dropped 36.4 percent. Total mortality rate from all cardiovascular disease declined 26.4 percent during the ten year period.

Through the complementary activities of research, professional and public education, and community service, the American Heart Association hopes to continue to make great strides in achieving its goal of the reduction of premature death and disability caused by cardiovascular disease. Yet, none of these activities would be possible without the fundraising activities that provide financial support for all of our services. In 1986-87, public support for the American Heart Association rose 8.1 percent over the previous year, raising a record high $163.7 million in revenues. This included $121.7 million in public contributions.

It was our impression that the intent of the House Ways and Means Subcommittee on Oversight throughout the 1987 UBIT hearings was to determine whether nonprofit organizations were unfairly accruing tax free dollars by participating in business activities that were unrelated to the organizations' tax exempt purposes. The American Heart Association was supportive of this intent. We have and continue to believe that income derived from unrelated business activities can and should be taxed. If taxes are not appropriately being paid, we believe that enforcement actions should be initiated.

The discussion options drafted by the Subcommittee do, however, raise a number of concerns for the American Heart Association. In general, we are concerned that the thrust of the options appears to an attack on a series of heretofore protected nonprofit fundraising activities. Ambiguities within the options permit varying interpretations. But it is clear that many American Heart Association income-producing activities would be adversely impacted by enactment of several of the options. Our concerns are more clearly delineated below.

I. "Substantially Related" Test

Option 1: Repeal "substantially related" test and replace it with a "directly related" test.

As an initial observation, the American Heart Association notes that neither the Internal Revenue Service (IRS) nor even the Small Business Administration (SBA) called for repeal of the "substantially related" test during the House Ways and Means Subcommittee on Oversight's 1987 UBIT hearings. The IRS testified, "although the 'substantially related' test raises a number of administrative and compliance concerns,... we believe the standard, as interpreted by the regulations, has conceptual merit." Likewise, the SBA, rather than calling for repeal of the "substantially related" test, stated, "In order to ensure that competitive commercial activities of nonprofit organizations are properly taxed, the unrelated business income tax should be retained, but the standard for determining which activities are taxable should be tightened. This can be accomplished by expressly defining what is meant by 'substantially related' activities in Section 513 of the Code."

The American Heart Association supports the position of the IRS on the issue of retaining the "substantially related" test. While recognizing that the "inherent generality" of this test creates some administrative difficulties, the IRS urged that "efforts focus... on obtaining more detailed information concerning the revenue of exempt organizations and the basis for treating them as tax exempt."

Further study of the revenue raising activities of nonprofits is more defensible than merely replacing the "substantially related" test with a "directly related" test. If there was agreement on any one issue throughout the Oversight Subcommittee's 1987 UBIT hearings, it was that no one knows the extent of unfair competitive activities in which nonprofits are currently engaged. Hence, analysis of this issue is necessitated.

Replacement of the "substantially related" test with a vague and undefined "directly related" test makes no sense, and in fact, works a disservice on both the nonprofit and the small business communities. Judicial interpretations and regulatory rules now provide some guidance as to the meaning of "substantially related." This informative record would no longer be applicable if the "substantially related" test were repealed, and no similar record would obtain for an undefined "directly related" test.

Option 2: Determine whether each income-producing activity standing alone is tax exempt.

The language of this discussion option is unclear. It may suggest only that each and every income-producing activity of a nonprofit is to be reviewed for its relatedness to the exempt purpose for which the nonprofit was granted its tax exempt status. If this is the intended interpretation, new legislation is unnecessary, since this is exactly what is required by current law. Any new legislation along these lines would merely be a reiteration of currently enforced statutory principles.

This option could, however, be interpreted to suggest that the income-producing activities of nonprofits in and of themselves are to be judged exempt or non-exempt. This judgment would be made regardless of the relationship such activities might have to the purpose for which the nonprofit was granted its tax exempt status. Under such an interpretation, door-to-door solicitation by volunteers might be considered tax exempt. But a more commercial activity, for example, the retail sale of an item, most likely would not be so viewed. If this is the intent, the American Heart Association must voice its deep-felt concerns.

It is the American Heart Association's strong belief that unrelated business income tax law should not be altered to separate review of the income-producing activity from the purpose for which the nonprofit organization was granted its tax exempt status. To do so would be a disservice to the millions of Americans who might reap benefits from a nonprofit's income-producing activities.

An example is illustrative of our concern. Since the early 1970s, the American Heart Association has licensed the production of a cookbook, which contains hundreds of recipes, each contributed by one or another of the Association's 55 affiliates. The recipes are tested to ensure compliance with the American Heart Association's dietary recommendations. No similar competing product was available in the marketplace when the American Heart Association licensed the first edition of the cookbook. Then, as now, the cookbook provided an identifiable public health benefit through its widespread issuance of heart healthy recipes. The cookbooks may be purchased at any of a number of retail bookstores.

Under the above-detailed adverse interpretation of Option 2, income earned by the American Heart Association through its cookbook sales would be subject to tax since the income-producing activity, in this case, the retail sale of an item, cannot be viewed as tax exempt. This tax would be imposed regardless of the public health benefit that accrues by widespread dissemination of this material.

It is difficult to believe that this is the true intent of Congress.

> Option 3: Retain "substantially related" test; however, impose UBIT on specified activities whose nature and scope are inherently commercial.

Consideration of this option must address two distinct issues. Most importantly is the proposed imposition of an "inherently commercial" test. This new, additional language provides little direction to the nonprofit community or to the IRS. An "inherently commercial" standard is really no more definitive than the previously mentioned "directly related" test, and therefore, our previously mentioned concerns apply.

The listing of specified activities to which UBIT might be applied raises a second issue. The option suggests that the method of distribution might make an activity "inherently commercial." For example, one might imply from the option's listing of specified activities that while income from the sale of the American Heart Association cookbook at a retail outlet would be subject to tax, such income would be exempt from tax if the cookbooks were sold at affiliate offices.

If this is the intent of Congress, it must recognize that such legislation would serve only to penalize those nonprofits who seek to provide distribution to the greatest possible audience. Enactment of such legislation would necessarily limit the number of individuals who could benefit from this important and valuable information.

II. "Regularly Carried On" Test

> Option: Repeal "regularly carried on" test. Income from an activity that is not a trade or business would remain tax free.

Again, the American Heart Association notes with interest that neither the IRS nor the SBA raised the "regularly carried on" test as an issue during the Oversight Subcommittee's 1987 hearings. In fact, it would appear that the sole complaint giving rise to this option involves the organization and operation of a circus by a nonprofit association. If this is the case, this option would appear to be an overreaction. A single identified problem can best be addressed through existent enforcement mechanisms.

Ambiguities within this option raise new concerns for the American Heart Association. What makes something "not a trade or business" and thereby ensure that income earned therefrom is tax free? Trade is most commonly thought of as the exchange of one item for another of value. Would enactment of this option then mean that whenever a nonprofit provides an item or service in exchange for a donation "trade" has occurred subjecting earned income to a tax? An example might better illustrate our concerns.

Affiliates within the American Heart Association have developed a variety of fundraising activities including Heart Balls, Jump Rope For Heart, running events, etc. In each of these cases some form of a trade/exchange takes place: in the case of a Heart Ball, the cost of a ticket is exchanged for an evening of dinner and dancing; jump ropes might be given to those who raise money for the Association through a jump rope competition; and tee-shirts may be given to those paying an entrant's fee at a running event.

Are these the type of income-producing activities that Congress intends to tax? It seems unlikely. Surely Congress does not intend to impose a tax on these activities in which the monetary contribution far exceeds the fair market value of the item exchanged. Yet, no other legislative exceptions would protect these activities if the "regularly carried on" test were to be repealed. Although there is volunteer involvement in all American Heart Association special events, paid staff provide crucial assistance. In addition, rental fees must often be paid for the location where the activity is to be held. Occasionally, employment of additional individuals also occurs, for example, musicians are paid for their services at a Heart Ball. Hence, an exception for volunteer operation and/or donated property does not allay our concerns.

Providing an exception for a "once-a-year fund-raising gala event" would also provide little assistance since a state affiliate might organize a Heart Ball in each of the major cities within the state, resulting in the Affiliate earning income from more than one Heart Ball per year. Hence, although each major city might have only one Heart Ball per year, the state Affiliate would show involvement in several.

III. Royalty Income

> Option: Apply UBIT to royalties measured by net or taxable income derived from the property; or royalties received by an organization for use of property if such organization, or closely related organization, either (1) created such property, or (2) performed substantial services or incurred substantial costs with respect to the development or marketing of such property. Retain present law for certain non-working property interests, and exception for certain products that are part of the organization's exempt function.

Ambiguities within this option once again form the basis of the American Heart Association's concern. Which "certain non-working property interests" and which "certain products that are part of the organization's exempt function" will continue to be covered by present law?

In June 1987, the American Heart Association testified in detail as to the "commercial" activities in which the Association is involved. In summary review, the American Heart Association has participated in several corporate promotions, all of which are at the request of and in cooperation with for-profit corporations. In a promotion, the American Heart Association permits its name and logo to be used in a controlled manner in the promotion of a selected product of the corporation that satisfies appropriate Association standards or guidelines. In return, the corporation distributes or broadcasts an American Heart Association-approved health education message to the public and provides other designated benefits to the American Heart Association and the public. While many of the promotions generate contributions for the American Heart Association, the primary thrust of such activities is to provide public education.

In addition, the American Heart Association has entered into three license arrangements with for-profit corporations for the manufacture and sale of American Heart Association products, all of which are mission-related and were developed incidental to the conduct of the Association's exempt purpose. An American Heart Association cookbook containing heart healthy recipes is published by David McKay Publishing. A computerized interactive CPR training device is manufactured and sold by Actronics, Inc. A low-salt, no-sugar herb seasoning is blended and sold by InterAmerican Foods.

Income earned form these activities is not currently subject to tax. This has seemed only fair given the passive involvement of the American Heart Association in the corporate development of promotional activities and the sale of licensed products. The language of the discussion option is sufficiently ambiguous so as to suggest that these activities might be subject to tax if the option were to become law.

Unfortunately, it is the American public that will suffer if these activities are now subject to tax. Current law has allowed the American Heart Association, through its corporate promotion and licensure agreements, to deliver its public health education message to hundreds of millions of Americans. This large audience would not have been reached without the cooperative agreements that the American Heart Association entered into with for-profit entities. Enactment of this option would, therefore, serve only to limit the important public education activities of the American Heart Association.

IV Miscellaneous

Option: Modify rules applicable to organizations "testing for the public safety."

Without more information, it is difficult for the American Heart Association to fully and fairly comment on this discussion option. Nonetheless, we are concerned that this language could be broadly interpreted to encompass activities in which the Association is already engaged as well as other activities that are still in the development stage.

More specifically, our statement references corporate promotion activities undertaken by the American Heart Association in cooperation with for-profit corporations. As noted, the American Heart Association permits its name and logo to be used in a controlled manner in the promotion of a selected product of the corporation that satisfies appropriate American Heart Association standards or guidelines. Most frequently, the Association standard or guideline in issue relates to the American Heart Association dietary recommendations, which in general call for reduction in total dietary cholesterol consumption to less than 300 mgs. per day; reduction in total fat consumption to no more than 30 percent of total calories per day with saturated fat consumption to comprise no more than 10 percent of total calories per day; and reduction in consumption of sodium.

The American Heart Association would contend that reviewing products and/or recipes for consistency with the organization's dietary guidelines could be viewed as "testing for the public safety." Hence, a whole income-producing activity could be subject to UBIT, if this option were to become law, despite the clear benefit that accrues to the American people and the clear link to the mission of the organization.

In summation, the American Heart Association reiterates the position it publicly made before the House Ways and Means Subcommittee on Oversight in June 1987: Ample justification exists for nonprofit entities to participate in commercial enterprises, so long as the activity is substantially related to the exempt purpose of the nonprofit and was not the primary purpose for which the nonprofit was established.

The American Heart Association maintains that the "substantially related" test has been clarified through regulatory rules and judicial interpretations. To eliminate that standard now would work a disservice on the nonprofit community and eventually on the people whom the nonprofit community serves. As we suggested in 1987, where abuse of the "substantially related" text exists, specifically directed enforcement action is warranted.

The American Heart Association is most concerned with any attempts to thwart nonprofits' legitimate fundraising activities. We remind Congress that if our abilities are curtailed, in the end, it is your constituents that will be adversely impacted.

American Hospital Association

AHA

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Jack W. Owen
Executive Vice-President

April 15, 1988

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman

The American Hospital Association (hereinafter "AHA"), on behalf of its more than 5,100 member hospitals, welcomes this opportunity to submit comments on the Discussion Options Relating To The Unrelated Business Income Tax set forth in Press Release No. 16, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, dated March 31, 1988 (referred to herein as "Discussion Options") and the Description of the Subcommittee's Discussion Options, reported in BNA No. 61, Sec. L-1 (3/30/88) (referred to herein as "Description of Discussion Options").

Before addressing the specific Discussion Options and accompanying explanatory Description of Discussion Options, AHA must voice its concern with respect to certain portions of the description of present law on which certain proposals for change are based. Most importantly, the description of present law pertaining to medical equipment and devices, laboratory testing, and pharmaceutical drugs and goods set forth in the Description of Discussion Option I.B. seriously misrepresents the state of the law as it exists today and has for the past twenty years.

The description of present law generally applicable to these activities is stated as follows:

> Present law, as interpreted by some courts, generally exempts income from the following activities from UBIT: (a) fees derived by hospitals from laboratory testing provided to nonpatients (e.g., private patients of staff doctors); (b) in most cases, pharmaceutical sales by hospitals to outpatients and nonpatients; (c) sales and rentals of medical equipment and supplies by hospitals....

This description of the present law as exempting hospital income from laboratory testing of, and pharmacy sales to, nonpatients from UBIT is both inaccurate and at odds with twenty years of established precedent. Since 1968, the IRS' published position has consistently been that the sale of drugs to nonpatients, i.e., private patients of staff physicians, is an unrelated trade or business. Rev. Rul. 68-375, 1968-2 C.B. 245, deals with the sale of pharmaceutical supplies by an exempt hospital to private patients of physicians with offices in a hospital-owned medical building. After observing that the "[p]harmaceutical supplies are purchased from this pharmacy as an incident to the purchaser's visit to his private physician, rather than as an incident to his use of any of the hospital's facilities," the ruling holds that:

> [t]he sale of pharmaceutical supplies to these persons cannot therefore be considered a trade or business that is carried on by the hospital primarily for the convenience of its patients.... Furthermore,...this activity is not substantially related to the exercise or performance of the hospital's exempt functions....
>
> Accordingly, the sale of pharmaceutical supplies to the class of persons and under the circumstances described above constitutes the conduct of unrelated business.

See also Rev. Rul. 68-374, 1968-2 C.B. 242, which holds that:

> [t]here is no substantial causal relationship between the achievement of the hospital's exempt purpose and the sale of pharmaceutical supplies to members of the general public who do not otherwise avail themselves of the hospital's medical or diagnostic facilities. Therefore this sales activity constitutes unrelated trade or business....

The IRS has also consistently applied the same general rule with respect to hospital fees from laboratory testing of nonpatients. Rev. Rul. 85-110, 1985-2 C.B. 166, states this longstanding IRS position. The ruling deals with diagnostic laboratory testing of referred specimens from private patients of hospital staff physicians by a Section 501(c)(3) hospital. The ruling states, in part:

> The hospital receives gross income from its diagnostic laboratory testing upon specimens from members of the public who do not otherwise avail themselves of the hospital's medical or diagnostic facilities...there is no substantial causal relationship between the achievement of the hospital's exempt purposes and the provision of such testing to nonpatients...
>
> Further, the hospital's provision of diagnostic laboratory testing services on specimens from persons who are not its patients is not an activity carried on primarily for the convenience of its patients...
>
> Under the circumstances described above, the performance of diagnostic laboratory testing, otherwise available in the community, by a hospital exempt from Federal income tax under Section 501(c)(3) of the Code, upon specimens from private office patients of the hospital's staff physicians constitutes an unrelated trade or business....

These rulings spell out the IRS' present and longstanding position that hospital fees from laboratory testing of nonpatients and pharmaceutical sales to nonpatients are, as a general rule, unrelated business income.

While the Description of Discussion Option I.B. suggests that its conflicting statement of present law is based upon the interpretation of *some* courts, the fact is that in the last twenty years, there have been only three cases on point, only two of which have sustained the hospital's position, and then only on the basis of very special circumstances. In *St. Luke's Hospital of Kansas City v. United States*, 494 F. Supp. 85 (WD Mo. 1980), the plaintiff challenged the IRS' treatment of fees from laboratory testing of private patients of staff physicians as unrelated business income. The court held that a teaching hospital which conducted nonpatient laboratory testing on specimens needed for its teaching activities was not engaged in an unrelated trade or business because the outside testing contributed importantly and substantially to its teaching program.

Similarly, only one case, *Hi-Plains Hospital v. United States*, 670 F.2d 528 (CA. 5th 1982), held that drug sales to staff physicians for their private patients was not an unrelated trade or business only because such activity aided the hospital in attracting physicians to its rural community which otherwise would have been without adequate medical services.

More importantly, the court in the *Hi-Plains* case also held that drug sales to the general public, as opposed to private patients of staff doctors, would, if substantial, constitute an unrelated trade or business. See also *Carle Foundation*, 611 F.2d 1192 (7th Cir. 1979), *cert. denied* 449 U.S. 824 (1980), which also held that drug sales by an exempt hospital to private patients of staff physicians was an unrelated trade or business. Thus, the only relevant case law demonstrably does not stand for the general rule that laboratory testing of, and drug sales to nonpatients is exempt from the tax on unrelated business income.

With respect to the sale and rental of medical equipment and supplies, any implication that income from such sales and rentals to persons other than patients of a hospital is similarly exempt from UBIT under present law is also inaccurate. The IRS position on income from such activity is the same as its position on income from laboratory testing and drug sales, i.e., that income from the sale and leasing of medical equipment and supplies to nonpatients is unrelated business income.

Based on an accurate description of the present law, AHA respectfully submits that the patient/nonpatient approach developed and followed by the IRS to determine the taxability of income from hospital activities is reasonable, has not been subject to abuse, and is consistent with the obligation of our hospitals to serve their communities through the provision of both inpatient and outpatient services. Any attempt to discourage our hospitals from providing health care services in the most cost effective way, i.e., other than in an inpatient setting, by restricting exemption from UBIT to artificially created categories of outpatients, such as the "continuous care" patient, is contrary to public policy. We must recognize that the full range of a hospital's legitimate patient services extends from acute inpatient care through a wide variety of services, equipment, and supplies provided in outpatient settings, which include extended and skilled nursing care, as well as home health care.

The exemption from UBIT provided under present tax law for services rendered to all types of hospital patients also provides these institutions with the economic flexibility that is vitally needed to enable them to respond to the continuing changes that are taking place in the delivery and financing of health care. More than ever, hospitals are confronted with reduced operating margins, as a result of declining inpatient admissions; DRG reimbursement which lags behind the rate of inflation; inadequate Medicaid funding and unsponsored care costs; declining private reimbursement payments; shrinking charitable contributions; and spiraling capital costs associated with high technology. Unfortunately, these adverse economic factors are occurring in an environment in which society is demanding an ever increasing range of health care needs be met, such as the treatment of AIDS patients, the battle against drug and alcohol abuse, and more services and facilities to care for the growing population of elderly and infirm.

In addition to permitting a degree of economic stability by exempting patient care activities from UBIT, present law also enables tax-exempt hospitals to seek additional sources of revenue through the use of taxable subsidiaries. The continuation of these two facets of the tax laws is essential to our hospitals. AHA supports Congress' desire to close loopholes, to require taxable and tax-exempt organizations to pay their proper taxes, and to avoid widespread abuses that may result from overstretching the boundaries for exemption. At the same time, any drastic changes in the tax law which would adversely affect a hospital's ability to raise and maximize revenues through all legitimate means could have serious implications for the future health care of our nation.

Option I.: "Substantially Related" Test

With respect to the option of repealing the "substantially related" test and replacing it with a "directly related" test, AHA must reserve any final comment because, in the absence of any indication of what a "directly related" test is and how it would be applied, the distinction between a "substantially related" test and a "directly related" test can only be the subject of conjecture, which is an inadequate basis for commenting on changes in the tax law.

Nevertheless, any use of a "directly related" test must involve a recognition of the principle that the diagnosis, prevention, and treatment of disease through a broad spectrum of patient care ranging from acute inpatient care to care provided in a variety of outpatient settings, extending to assistance rendered in the home and facilities such as extended care facilities (ECF) and skilled nursing facilities (SNF), is directly related to the achievement of a hospital's exempt purposes. We would further note that any "directly related" test should also carry over the definition of hospital patients in Rev. Rul. 68-376, 1968-2 C.B. 246, and the various exceptions to the patient/nonpatient approach to determining the relatedness of hospital activities. See Discussion Option I.B. discussed below.

With respect to determining whether each income producing activity standing alone is tax exempt, AHA must again reserve final comment in the absence of any indication of how this test would work and be applied. We would, however, note that no income producing activity of a hospital can be judged to be exempt or nonexempt without reference to the hospital's mission of providing a full range of cost effective inpatient and outpatient services, and in otherwise carrying on special activities, such as medical training and education and offering services to benefit its community.

With respect to the option of retaining the "substantially related" test, but imposing UBIT on specified activities whose nature and scope are inherently commercial, rather than charitable, AHA opposes such an approach because the term "inherently commercial" is not susceptible to a fair and meaningful definition. Almost every income producing activity of an exempt hospital will have a commercial counterpart, i.e., they are activities which will also be carried on by a for-profit medical group practice or a commercial firm selling the same health care goods or services. If specific activities that are also carried on by commercial counterparts of exempt organizations are deemed "inherently commercial", few, if any, patient care activities and services provided by an exempt hospital would be related to its exempt purposes because no consideration would be given to whether or not the activity furthers the care of the hospital's patients, or otherwise makes some special contribution to community health care.

AHA believes that the present law, which consists of a well-defined body of IRS precedents that have with few exceptions been accepted without challenge by exempt hospitals, provides a far more accurate distinction between the commercial and charitable activities of an exempt hospital than the "inherently commercial activities" discussed below. AHA questions the wisdom of supplanting this carefully developed, and workable distinction with the inherently ambiguous and inherently inadministrable test of "inherently commercial activities."

Discussion Option I.A. Gift Shops and Book Stores

1. In General. First, AHA recommends that the current exemption for UBIT under Section 513(a)(1) for activities in which substantially all of the work is performed by volunteers, such as members of a hospital auxiliary, should be retained. These volunteers should not be discouraged from donating their time for the benefit of their hospital by taxing as UBI the net income generated by their efforts.

Second, AHA recommends the adoption of the exception for the sale of articles purchased from an on-premises gift shop for use by or for patients. However, we recommend that this exception also cover the sale of articles generally used by hospital employees, students, interns, residents, and members of the medical staff. As indicated in Rev. Rul. 69-267, 1969-1 C.B. 160, the provision of a facility which enables such persons to remain on the hospital's premises and be available for hospital duties improves patient care and hospital efficiency.

Discussion Option I.B.: Medical Equipment and Devices, Laboratory Testing and Pharmaceutical Drugs and Goods

This Discussion Option is one which AHA believes is most likely to impair and impede our hospitals' ability to render services to its patients in the most cost effective manner. This Option apparently intended to curb alleged inequities in the present tax law. However, as indicated above, the description of the applicable present law is inaccurate and misleading.

Under present law, the tax treatment of the activities is predicated upon a patient/nonpatient approach applied by the IRS to a hospital's sale or rental of goods and services with certain limited exceptions that are available upon a showing of special facts and circumstances that demonstrate that the sale of services or drugs to nonpatients serves a specific charitable purpose. Examples of special facts and circumstances include the provision of services or drugs otherwise unavailable in the geographic area, the integration of testing lab specimens into a teaching or medical research program of a teaching hospital, and the availability of expensive, highly specialized high-tech equipment not otherwise found in the community.

The cornerstone of the IRS' patient/nonpatient approach is Rev. Rul. 68-376, 1968-2 C.B. 246. Under this ruling, the following class of persons have been considered to be "patients" of a hospital since 1968: (1) persons admitted to a hospital as inpatients; (2) persons receiving general or emergency diagnostic, therapeutic, or preventive health services from outpatient facilities at the hospital; (3) persons directly referred to the hospital's outpatient facilities by their private physician for a specific diagnostic or treatment procedure; (4) persons refilling a prescription written during the course of their treatment as a patient of the hospital; (5) persons receiving medical services as part of a hospital administered home care program; and (6) persons receiving medical care and services in a hospital affiliated extended care facility.

On the other hand, the sale or leasing of services, drugs, supplies, and equipment to nonpatients, such as private patients of staff physicians and other members of the general public, such as off-the-street patrons of a hospital's satellite pharmacy, is treated as an unrelated trade or business. See Rev. Rul. 68-374, 68-375, and 85-110, op. cit.; Carle Foundation v. United States, op. cit.

The same patient/nonpatient distinction would apply to the sale of medical equipment and devices. Where such items are sold or leased to hospital patients under Rev. Rul. 68-376, such sales or rentals would not constitute an unrelated trade or business. On the other hand, income from the sale or rental of medical equipment and supplies to nonpatients would be subject to UBIT.

The principal failing of this option is that it attempts to make a distinction between the classes of persons recognized as hospital patients under Rev. Rul. 68-376 by limiting the exemption of patient services from UBIT to inpatients, emergency outpatients, and "continuous care" outpatients to the exclusion of the other classes of hospital patients listed in Rev. Rul. 68-376. The term "continuous care outpatient" is not a term of art in the health care industry and its precise meaning is unclear. If it is intended to distinguish "continuous care" outpatients from other types of outpatients by implying that a person's first visit to use a hospital's outpatient facilities is insufficient to make him a patient of the hospital, and that such person becomes a hospital patient only upon the second visit, or that a hospital's continuing care can only be rendered on its premises, and not as part of a hospital's home care, SNF, ECF and similar programs, such a definition falls far short of reflecting the kind of commitment to cost effective outpatient services and continuity of care demanded by the Federal government and the public.

Other than the desire of small businesses to discourage fair competition by exempt hospitals that provide a full and complete range of less costly outpatient services for the benefit of the community, there is no compelling reason to change or modify the existing body of law that has been developed by the IRS. The novel concept of a "continuous care outpatient" is really little more than a procrustean bed concocted by small businesses for exempt hospitals to lie in. Unfortunately, it is the general public that must ultimately suffer through the payment of higher health care costs and the loss of services that hospitals are best equipped to provide, if this effort to inhibit the further development and expansion of outpatient services by our hospitals succeeds.

In examining other facets of this issue, we note that under the third example provided in Discussion Option I.B., income from the sale of crutches to persons treated at a hospital's emergency room would be exempt from UBIT, apparently under the theory that the sale is merely incidental to the hospital's outpatient services, and that the crutches will promote the recovery and well-being of the patient being discharged. In other words, the sale is an integral part of the services rendered by the hospital for its patient. We submit that no meaningful distinction can be made between this admittedly related sale and similar activities, such as the sale of oxygen tanks to an emphysema patient upon his first visit to the hospital's outpatient facility or the leasing of a portable hemodialysis unit to a discharged patient that has been treated for kidney disease or a similar patient enrolled in the hospital's home health program. All of these sales of medical equipment and supplies are an integral part of the hospital's commitment to preserving the lives of its patients, and any attempt to inhibit a hospital's total effort towards attaining these goals through both inpatient and outpatient care, and the sale of services and supplies that are a natural concomitant of such care, would not constitute sound public policy.

Exempt hospitals are not being unreasonable in seeking to retain present law. Under this law, the sale and rental of goods and services to the general public (or nonpatients), is generally taxable as an unrelated trade or business. We do not seek to change this result. We seek no more than to avoid the enactment of changes in the law that would most assuredly make the continued development and expansion of the very same outpatient services and continuity of care, which are universally regarded as a less costly and more desirable alternative to inpatient care, less attractive to our hospitals.

Finally, we believe that given the constant changes and advances in the delivery of health care, any approach which seeks to substitute the rules for UBIT upon specific types of activities, with specific exceptions to their taxability, for the more general patient/nonpatient approach (with carefully developed limited exceptions) under present law, is doomed to failure.

Changes in the delivery and financing of health care occur with such rapidity that lists of specific activities with specific exceptions will become outdated by the time they are enacted into law. Our health care institutions need to retain the flexibility and predictability provided by present law, as well as the economic stability that would be lost by the unfair taxation of income derived from legitimate patient care activities. Accordingly, AHA believes that this Discussion Option be rejected.

Discussion Option I.C.: Health, Fitness, Athletic, and Recreational Activities

Many hospitals provide health, fitness, and athletic activities for their patients as a part of a medically integrated health program. These activities should be treated as substantially related to the hospital's exempt functions, particularly in the areas of rehabilitative services and preventative health care.

However, if an exempt hospital offers such activities to the general public and they do not possess the attributes of a program which is medically integrated with the hospital's health care functions, AHA is in accord with the Subcommittee's proposal to base the relatedness of such activities upon the ability of a reasonable cross-section of the community to afford the cost of the facilities in question.

Discussion Option I.E.: Restraurants and Food Services

Except under the limited circumstances described below, AHA supports the proposal for treating income from adjunct food sales as UBIT unless they are (1) provided on the premises of the organization and (2) primarily for the benefit of students, faculty, visitors, and employees of the organization. However, in the case of exempt hospitals, the exception for UBIT should also extend to patients of the hospital (e.g., to a meal purchased by a patient while waiting for an outpatient procedure to be performed), and members of the hospital's medical staff while they are present in the hospital in connection with treating patients, performing administrative duties, or providing medical education and training.

In addition, while AHA supports the requirement that the adjunct food service sales should be provided on the organization's premises as a general rule, an exception should be made for off-site food services provided by hospitals to persons who are poor, elderly, shut-ins, and residents of facilities such as nursing homes, as proposed in the fourth example set forth in this Description of Discussion Options I.E. A further exception should be made for food supplements sold for off-premises consumption as part of a hospital's medically supervised weight reduction program for inpatients and outpatients of the hospital.

Discussion Option I.G.: Hotels

AHA supports the use of the fourth example set forth in this Discussion Option which would exempt from UBIT income from a hotel type facility owned by a hospital for its patients and families. This example is consistent with PLR 8635078 which also recognizes the relatedness of such facilities to a hospital's exempt functions.

Discussion Option I.H.: Routine Testing

AHA supports the exemption from UBIT for income from routine testing for hospital patients, with the understanding that the definition of the term "hospital patients" in Rev. Rul. 68-376 will continue to apply. AHA further supports the Description of Discussion Options I.H. proposal to exclude pathology testing of nonpatients where the specimens derived from such testing are a part of an academic or clinical training program for medical students or laboratory technicians.

However, the implication in the third example in Description of Discussion Options I.H. that this exception would only apply to income derived from pathology services conducted by students as part of their academic or medical training should be revised to take into consideration the fact that in teaching and training pathology students, the techniques and procedures involved in such teaching activities include the performance of testing by a trained pathologist or laboratory technician to demonstrate proper techniques and procedures, and are not limited to testing performed only by the students themselves.

Discussion Option II: Convenience Exception

Despite some overlap between the convenience exception and the "substantially related" test, we recommend the retention of the convenience exception primarily for purposes of administrative convenience by the IRS. In particular, the definition of "patients" set forth in Rev. Rul. 68-376 for purposes of the convenience exception under Section 513(a)(2), has provided an understandable and administratively useful means of distinguishing between services provided to hospital patients (which are related to its exempt purposes) and services provided to nonpatients (which, as a general rule are not).

However, if the convenience exception is repealed, the "substantially related" test, which would then serve as the sole standard for determining the applicability of UBIT to hospital activities, should continue to apply the patient/nonpatient approach and the definition of hospital patients in Rev. Rul. 68-376 that have so far been applied to UBIT in the context of the convenience rule. We note that the special circumstances exceptions to the patient/nonpatient approach are already a part of the "substantially related" test under IRS precedents.

Further, if the convenience exception is repealed, it should be made clear that services and facilities provided by a hospital for its employees, patients, and students, such as gift shops, parking lots, coffee shops and cafeterias, which contribute to the efficient operation of the hospital and/or promote the recovery of the hospital's patients, will continue to be treated as substantially related to the hospital's exempt purposes in accordance with Rev. Rul. 69-267, 1969-1 C.B. 160, Rev. Rul. 69-269, 1969-2 C.B. 160, and Rev. Rul. 69-268, 1969-2 C.B. 160, respectively. Similar facilities and services made available to visitors and the hospital's medical staff are also treated as related render the "substantially related" test under the three rulings cited above. See also Discussion Option I.A.1. exempting gift shop sales to inpatients from UBIT.

Discussion Option III: "Regularly Carried On" Rule

AHA supports the retention of the "regularly carried on" rule because the frequency and continuity with which an activity is conducted by an exempt organization has a direct bearing on the question of whether it is conducted in furtherance of commercial or exempt purposes. Generally speaking, most commercial activities are regularly carried on to maximize their revenues, while the fact that many activities of an exempt organization are not conducted on a frequent and continuing basis is indicative of the lack of a commercial intent.

However, if the "regularly carried on" rule is repealed, AHA supports the proposal reflected in the second example of Description of Discussion Options III to make the tax on unrelated business income inapplicable to certain fund raising events which are not carried on a regular and continuing basis.

However, the exemption for UBIT for hospital auxiliaries and other charitable fund raising organizations should not be limited to fund raising events occurring only once a year. The exception from UBIT for infrequent fund raising events should make it clear that a charitable organization may carry on a number of different fund raising events during the course of the year, or alternatively, carry on the same type of fund raising event more than once a year.

Discussion Option IV: Royalty Exclusion

AHA does not oppose the application of UBIT to royalties measured by net or taxable income derived from the property, or royalties received by an organization for the use of property where such organization or another closely related organization performs substantial services or incurs substantial costs with respect to the development or marketing of such property.

However, AHA does not believe that royalty income should be subject to UBIT where it is measured by either the gross income of the licensee or a negotiated fixed fee merely because the exempt organization created the property in the performance of its exempt functions. For example, if a hospital develops a software program for its own use, and upon completion of the development of such software program used in its exempt function, it is able to license the program to other for-profit or tax-exempt hospitals for royalty payments based upon a fixed fee or a percentage of the licensee's gross income, the hospital would only merely be putting to use a by-product of its exempt functions. Absent any initial commercial intent, a hospital should be able to generate what is essentially passive income without being penalized by the imposition of UBIT on the royalties it receives under such circumstances.

Discussion Option V: Deduction From Taxable UBIT

AHA supports the increase of the $1,000 UBIT deduction to $5,000 or $10,000, but opposes the proposed discrimination against more successful unrelated trade or business by the phase out of such deduction beyond a $50,000 income level. AHA notes the proposal to limit the increased deduction to activities "directly carried on" by an exempt organization, but reserves any comment on this proposal because the meaning of activities "directly carried on" by an exempt organization, and the application of such a rule, has not been explained and is unclear as stated.

Discussion Option VII: Taxable Subsidiaries and Joint Ventures

A: Definition of Control

Description of Discussion Options VII, Option 1. AHA does not believe that there has been any widespread attempt to circumvent the controlled organization rules under Section 512(b)(13) in the health industry, and in fact, believes that most taxable subsidiaries in restructured health care systems are wholly owned by the exempt parent. If information developed by the IRS indicates substantial abuse in this area on the part of any group of tax-exempt organizations, we would not oppose the adoption of a more stringent standard for such organizations.

However, we believe that control should be triggered by the possession of more than 50% of stock ownership or voting power, i.e., at least 51%. The possession of only 50% of stock ownership or voting power is not sufficient to provide the exempt organization with the ability to control the alleged subsidiary.

Description of Discussion Options VII, Option 2. AHA opposes this proposal because the attempt to treat control of a taxable corporation by an exempt organization through the attribution of the stock ownership or voting control of other unrelated exempt organizations is inconsistent with the rules defining "control" for purposes of other provisions of the Internal Revenue Code. Further, AHA believes that given the competitive environment in which most hospitals operate, the example provided in this Option is highly atypical of the health care industry. The example also presupposes, but does not state, that the arrangement described also involves some plan to circumvent Section 512(b)(13) by having the for-profit organization make tax deductible payments to its three exempt shareholders in the form of interest, rents or royalties. Such arrangements would also be unusual in the health care industry.

B. Taxation of For-Profit Subsidiaries

AHA opposes this Discussion Option. It does not believe that the placement of profitable and unprofitable business activities in the same taxable subsidiary for purposes of offsetting income against losses is a prevalent practice in the health care industry. To the limited extent that such offset may occur in a taxable subsidiary, AHA believes it is more the result of losses occurring because of start-up costs and the time lag involved in developing a market for a taxable subsidiary's business, than because of any initial intent to place potentially unprofitable business in a taxable subsidiary for purposes of creating tax losses.

As a general practice, restructured hospitals and their parent corporations look to the placement of new businesses in taxable subsidiaries as a means of generating profits, not losses. Regardless of the net tax effect of placing profitable and unprofitable businesses in a taxable subsidiary, the community leaders who sit on the board of trustees of community hospitals are rarely impressed by the creation and operation of a business in a taxable subsidiary that loses money.

C: Aggregation

AHA strongly opposes the aggregation of the income and activities of separately incorporated "controlled" subsidiaries of an exempt hospital or parent corporation for purposes of determining the primary purpose of an exempt parent or subsidiary, particularly if such aggregation is combined with a control test based upon the possession of only 50% of stock ownership or voting power. A respect for the sanctity of the separate identity of legitimate corporate entities is entrenched in our laws and has been relied upon by hospitals and the health care industry in connection with their corporate restructuring activities. See Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1946).

At the same time, the IRS has a developed set of fair and workable rules for attributing the activities of a subsidiary to its parent where (1) the subsidiary has not been organized and operated for a bona fide business purpose, and (2) the parent so controls the affairs of the subsidiary that it is merely an arm, agent or instrumentality of the parent. See GCM 39326; IRS PLR 8709071; 8805059. AHA believes that these well-established rules for attribution are sufficient for determining the exempt or nonexempt purposes of a separately incorporated parent corporation or exempt subsidiary of such parent.

However, if serious consideration is given to this Option, AHA recommends that three points be clarified with respect to its application. First, it should be made clear that the income and activities of all corporate subsidiaries, both taxable and tax-exempt alike, will be aggregated for purposes of determining the primary purpose of the tax-exempt parent or any of its tax-exempt subsidiaries.

Second, any implication that may arise out of the example presented in the Description of Discussion Options VII. C. that all of the subsidiaries are necessarily taxable entities should be clarified. For example, a hospital's or parent corporation's subsidiary, which sells drugs or medical supplies to the hospital's outpatients, or provides nursing home care in accordance with the IRS requirements for the exemption of such facilities, would be able to qualify as exempt, rather than taxable, entities.

Third, for purposes of aggregation, the term "primary purpose" should be defined. With respect to a Section 501(c)(3) organization, a primary purpose could be viewed as a substantial nonexempt purpose (Reg. Sec. 1.501(c)(3)-1(c)(1)) or a purpose reflected by more than 50% of the organization's activities (Reg. Sec. 1.501(c)(3)-1(e)). The definition of the term "primarily", as used by the Supreme Court in Malat vs. Riddle, 383 U.S. 569, 86 S. Ct. 1030, to mean "of first importance" should be applied. In other words, in measuring the exempt purposes against the nonexempt purposes of the aggregate group, the purpose which represents at least 51% of the group's activities should be the one to reflect its primary purpose.

Fourth, in the event that an aggregation approach is mandated, the indicia to be used for determining primary purpose should be spelled out, and such indicia should be based upon either the (1) gross income, (2) total costs, and/or (3) time spent by employees of all of the aggregated entities.

Discussion Option VIII: Allocation Rules

AHA appreciates the Treasury Department's concern with the difficulty in determining what are reasonable allocations for general overhead and depreciation between related and unrelated uses. However, AHA respectfully submits that the most equitable solution to this problem lies in the development of better guidelines by the IRS and improved audit techniques for examining agents, rather than in subjecting exempt organizations to an unfair economic disadvantage in relation to their commercial counterparts, who can avail themselves of deductions for depreciation and general overhead expenses allocable to two or more businesses carried on by their taxable corporations.

Improvements in the information returns used by exempt organizations for reporting unrelated business income on Form 990-T can also ameliorate any abuses. For example, Form 990-T could request full disclosure of the basis used for allocating general overhead expenses and depreciation and elicit other information that would provide adequate tools for an examining agent to determine the reasonableness of such allocation.

Discussion Option IX: Tax Information Reporting/IRS Administration

With respect to the first option relating to Form 990-T, AHA supports the recommendation to expand the information available on Form 990-T, but notes that information regarding the activities and income claimed to be exempt or excluded from UBIT and revenue sources such as contributions and grants, could more effectively be shown on Form 990. If an organization forms a good faith belief that it has no unrelated business income, and accordingly does not file Form 990-T, the information sought under this option on Form 990-T would simply not be available to the IRS. It would therefore make more sense to elicit this same information on an expanded Form 990.

With respect to the second option relating to Form 990, as indicated above, the type of information referred to in the previous option should more appropriately be part of more detailed reporting on Form 990.

AHA stands ready to assist the IRS in any way possible in preparing or revising forms, such as Forms 990 and 990-T, and the instructions thereto, that will (1) provide the IRS with the information sought in any reasonable manner, and (2) aid tax-exempt hospitals in complying with the IRS information requirements.

With respect to the third option, AHA supports the recommendation that the IRS consider short form reporting from small exempt organizations (based on revenues), which could include such organizations as hospital auxiliaries.

With respect to the fourth option regarding the filing of consolidated information returns for affiliated groups including exempt organizations, the AHA endorses any reasonable means for providing the IRS with the information it needs to conduct informed audits. However, the accounting, auditing, reporting and legal implications of requiring a consolidated information return for "affiliated" exempt and nonexempt organizations, particularly for organizations operating in such a tightly regulated field as health care, is staggering. Furthermore, the potential problems would be exacerbated if the proposal to treat taxable subsidiaries as controlled based upon only a 50% interest in the subsidiary's stock or voting power is adopted.

AHA suggests that information regarding affiliates can be obtained by the IRS in a more administratively feasible manner by requiring appropriate information and attachments to an expanded Form 990. Such approach would accomplish the desired result without causing the kind of serious administrative and legal problems that could follow from the creation of the legal fiction of a consolidated group of exempt and nonexempt entities for purposes of filing an information return.

With respect to the fifth option regarding integrated examination program for exempt organizations and subsidiaries, AHA would not oppose the concept of an integrated examination for exempt organizations and subsidiaries, so long as the exempt organizations have legal access to the returns of Form 1120 filed by any taxable corporations which are treated for purposes of the audit as subsidiaries of an exempt organization, but which are not wholly-owned subsidiaries.

With respect to the sixth option, AHA supports any reasonable studies that will enhance the understanding of the IRS on structural and operational conditions in the health care field for purposes of the proper administration and enforcement of the tax law. AHA would, however, request that it be afforded an opportunity to make its knowledge and experience of health care matters available to the IRS with respect to those studies that have particular relevance to reorganizations and the use, purpose and effect of joint ventures involving tax-exempt hospitals and other providers.

Discussion Option: X.: Miscellaneous Options

Option D: Piecemeal Exclusion of Certain Activities

Repeal of Section 513(e): First, the description of this 1976 legislation set forth in Description of Discussion Options X., Option D.(e), which constitutes Section 513(e) of the Internal Revenue Code, is incomplete. It fails to include the requirement of Section 513(e)(3) that the services involved must be provided at a fee or cost which does not exceed the actual cost of providing such services.

This omission is significant since Section 513(e), by reason of the provisions of Section 513(e)(3), provides an incentive to larger hospitals to make their services available to smaller hospitals at a savings in cost to the latter. Furthermore, although Section 513(e) was enacted as a piecemeal addition to the UBIT provisions, there is nothing to suggest that the public policy reflected in Congress' enactment of Section 513(e) in 1976 has in any way changed.

Section 513(e) provides a convenient administrative rule which facilitates IRS examinations and encourages larger hospital to make certain services which they provide for themselves and their patients available to small exempt hospitals at lower costs than would be involved if these smaller hospitals provided such services for themselves. Accordingly, absent any evidence of substantial abuse or a change in the public policy behind the 1976 enactment of Section 513(e), these provisions should be retained.

If Section 513(e) is repealed, the legislative history should make it clear that such action is not intended to disturb the IRS' current treatment of the provision of services by one exempt hospital to another exempt hospital and its patients under the "substantially related" test for UBIT. In some cases, one hospital may provide patient care services which the recipient hospital lacks. The IRS position is that under these circumstances, the provider institution is directly involved in the promotion of health of the individual, regardless of whose patient he or she is.

For this reason, the IRS may exempt from UBIT income derived from activities of a provider hospital which enhance the recipient hospital's ability to provide the highest quality of care to its patients. Examples of such situations are the provision of EKG services to an exempt hospital lacking full-time EKG coverage (PLR 8004011); orthotic and physical therapy services for patients of other institutions (PLR 8013052); the provision of radiology services to health care providers in a rural area (PLR 8305115); and the operation of an alcohol treatment center for another health care provider (PLR 8301092). The exemption from UBIT for special services of this type should continue to be treated as substantially related to the providing hospital's exempt purposes and should not be disturbed by the possible repeal of Section 513(e).

Conclusion

The AHA would like to thank the Subcommittee for the opportunity to present its views on these important tax policy issues. We respectfully request an opportunity to testify at the proposed Subcommittee hearing on this issue.

Sincerely

Jack W Owen

Jack W. Owen
Executive Vice President

STATEMENT OF THE AMERICAN INSTITUTE OF ARCHITECTS FOR THE U.S. HOUSE OF REPRESENTATIVES OVERSIGHT SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS

APRIL 15, 1988

Submitted by Ted P. Pappas, FAIA, President

The American Institute of Architects appreciates the opportunity to provide its views on possible changes in the application of the unrelated business income tax (UBIT) to trade and professional associations. The American Institute of Architects (AIA) is a nonprofit professional association representing the nation's architects. We have chapters in each state and in many localities that promote AIA issues on a local basis. Each of our entities are separate legal corporations, all paying their appropriate taxes individually. The national AIA is a 501(c)(6) organization and pays taxes in accordance with the 990-T regulations.

The AIA commends the Oversight Subcommittee for its deliberate approach to UBIT reforms and particularly applauds the subcommittee's efforts to seek information from the broad range of trade and professional associations that would be significantly affected by the decisions the Subcommittee may ultimately reach on this issue. We support Congressional examination of the UBIT area of the tax code to determine improved ways to reduce abuse of this section of the tax code. We endorse stepped-up enforcement of the UBIT and tighter reporting requirements by tax-exempt organizations. At the same time, we strongly urge that any legislation carefully distinguish between necessary reforms to curb abuse and provisions which may undermine the public purpose activities of professional associations that the tax-exempt status was meant to foster. We support targeted reforms and oppose broad brush solutions.

We note that the list of discussion options does not include the UBIT on net investment income. We strongly support the omission of this item from consideration. We also oppose any efforts that may arise to couple proposals to apply UBIT to net investment income with other unrelated legislation. Such action would, of course, undermine the integrity of the review of the discussion options.

In responding to the discussion options for legislative change of the UBIT, it is important to recognize AIA's activities and practice under current law. We already pay substantial taxes on the income from those activities deemed unrelated to the tax-exempt purposes of the organization. For example, we pay taxes on advertising income. We also pay taxes on the rent we receive from tenants in our building. And we pay taxes on income from sale of lists.

At the same time, the income we receive from investments and royalties is used for many activities that benefit both the profession and the public at large. They include:

o Public television programming to educate the public about the role of the architect in society.

o Research on life-safety aspects of building design such as long spans.

o Scholarships for students throughout the United States. The AIA spends over $300,000 a year on this purpose.

o Public outreach programs to relieve the plight of the homeless. The AIA's Search for Shelter program, operating in more than 30 cities, brings together architects, community leaders, elected officials, homeless advocates, and others to find creative solutions to local homeless conditions.

o Disaster relief teams dispatched at AIA expense to help stricken communities rebuild after hurricanes, earthquakes, floods, and other natural disasters.

o Teams of volunteering architects who work with urban communities to develop long-range, comprehensive plans for historic areas and other specifically designated places.

If the income that allows us to engage in these activities is reduced because of substantial additional taxation, we would have to cut back or eliminate them, to the detriment of the profession and the public. Because these are not activities performed by the private sector, it would be up to the government to fill the gap. The other alternative would be substantial and, frankly, unacceptable increases in dues to our members, the overwhelming number of whom are in small businesses. They belong precisely and ironically to the general class of people whose interest this whole exercise in UBIT review is designed to protect.

For the most part, the discussion options for subcommittee consideration do not apply to the AIA. There are others that could have substantial impact on our ability to generate the revenue to support our public purpose activities. (One option actually treats us very differently from the private sector.) A major problem generally with many of the options is that they inadequately or unclearly separate the abuser from the non-abuser and may have the effect of penalizing professional associations inappropriately.

We would like to focus on several of the options in particular.

One option would subject certain bookstore sales to taxation apparently based on the off-site nature of the sales. The AIA operates a bookstore. A number of the items it sells may properly fall under the list of items that would be subject to tax. Other items sold on-site are clearly related to the purposes of the organization and therefore would not be subject to tax. We do not have a catalog sales program aimed at the general public. In addition, there are two major kinds of publications that the AIA produces and distributes on a national level to its members and the public through the bookstore and mostly through off-site transactions; and which are essential to the architectural profession and the safety of the public. The first is the AIA contracts and forms which are actually sold separately and the second is the Handbook of Professional Practice.

The AIA contracts and forms are the standard documents in the construction industry that establish clear lines of responsibility and accountability between architects and contractors. These documents help ensure that the buildings we design are safe for the public. No other organization or corporation competes with AIA in the production of these documents, on which the AIA holds the copyright. They are recognized as being fair and complete by the building industry.

The Handbook of Professional Practice is a four volume series written by AIA members. They do not receive compensation for this work. Its purpose is to provide a comprehensive educational resource guide to the practice of architecture. The handbook is also sold to architectural schools for use in core curricula. As with AIA Contracts and Forms there is no private competitor.

The National AIA sells most of its contracts and forms to AIA state and local societies which in turn sell them to AIA members and contractors. The handbook is marketed in much the same fashion. Whether these publications are sold on-site or off-site has no bearing on their educational and/or public safety purpose. In our opinion, the UBIT should not be levied on the income received from sales of these publications.

The AIA is also concerned with the royalty issue. We are in support of the subcommittee's suggestions to apply UBIT to royalties measured by net or taxable income, but not with the additional language calling for the application of UBIT to royalties received from other purposes, specifically royalties for which the related organization performed substantial services or incurred substantial costs. A good example of this is our publication entitled Architectural Graphic Standards. This book is produced in cooperation with a commercial publisher and is largely the result of members' input. Over 200 AIA members contribute to the content of this publication. They receive no royalties or compensation for their work. The book is recognized by the profession as the bible of the industry. Since the copyright was deeded to both the AIA and the commercial publisher in the early 1900's, the AIA has received royalties on the sale of the book. The entire purpose of AIA's involvement is educational, yet under the discussion options, all royalties would be subject to taxation due to AIA's substantial cost and involvement in the development of the publication. The purpose again is educational, not commercial, but your option does not seem to differentiate.

Probably the most drastic measure contained in the list of options has to do with allocation rules. The issue here is one of equity and fair taxation rules because this option would deny normal deductions. The major concern involves the non-deductability of overhead. The AIA feels that once an item is deemed to be taxable, normal taxation rules should apply, i.e., revenue minus direct expense minus indirect expense minus overhead equals profit. In today's association environment, the executive vice president, general counsel, and financial management staff spend a considerable amount of time on income-producing projects. Considering the likely tightening of the laws in the UBIT area, it will be even more important to have management oversight on these activities. To exclude deductions for general overhead properly allocable to activities subject to tax is inconsistent with the tax laws and is a real discrimination against organizations like ours. In the area of advertising, to allow only direct advertising expenses ignores the accounting theory of full cost absorption, which private enterprise may rely upon to reduce their tax burden. It also assumes illogically that people buy a magazine for the advertising not the content. Elimination of this deduction would therefore give private enterprise an unfair advantage over associations in the performance of similar functions.

The AIA also maintains a 501(c)(3) foundation whose major purpose is to educate the public on the value of architecture. From time to time the foundation displays exhibitions of works that are important to the history of architecture. In connection with these exhibitions, they also sell books on the subject matter at the exhibition. A good example is a recent exhibition on British country houses at which where the foundation also offered for sale a book on the subject. Under your consideration to drop the commercial exception as it pertains to UBIT, the sale of these books would become taxable. The purpose for which the American Architectural Foundation is involved with the sale of these books is to educate the public on architecture. The purpose is not the commercial sale of books. The sale of the books is interwoven with the educational purpose of the exhibit, which is not only to inform but also to stimulate further public interest in the subject at hand and in architecture in general.

The AIA is generally in support of your initiative to obtain more information on the 990-T and would encourage you to obtain more factual data before you legislate these issues. Please be aware that associations are different from private enterprises in their purpose and much needs to be understood before fair taxation can be accomplished.

We recognize that there needs to be some tightening of the laws that pertain to the UBIT and we are prepared to make the necessary adjustments. We do, however, ask that any new provisions be as clear as possible and as targeted as possible, so that abuses are reduced and worthwhile activities encouraged and protected. This statement, we hope, will promote that goal.

AMERICAN
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Francis J. Soldovere
Executive Director

April 15, 1988

The Honorable J. J. Pickle
United States House of Representatives
242 Cannon House Office Building
Washington, DC 20515

Dear Congressman Pickle:

Having just reviewed your proposal relating to Unrelated Business Income Tax, I would like to register the concern of the American Kidney Fund with regards to the options offered for consideration.

As a national voluntary health agency providing direct assistance to needy kidney patients, we are certainly aware of the many operational realities that continually eat into the funds available for those whom we strive to serve. Maintaining a viable program for a rapidly expanding population of kidney patients is difficult enough with ever increasing costs for materials, travel and personnel. Additionally, as an organization primarily dependent upon direct mail fund raising, we have seen postage costs spiral at a rate far exceeding national inflation levels.

One way in which we seek to generate new funds is through the development of a modest, yet, effective special events program and now you are proposing that income from such endeavors be subject to UBIT. While many of the options outlined in your proposal would not effect the American Kidney Fund directly, there are several which would make an immediate impact.

Our objective in this letter is to identify concerns with the specific options that are of concern to AKF. However, and we believe more important, we are concerned with the entire direction such proposals will have on the nation in general and the philanthropic arena specifically.

The AKF is in the process of launching an affinity card program through which our supporters could generate funds by purchasing consumer goods and services. The fact that we are taking this innovative approach to raising money should not in itself constitute a degree of unrelatedness, but, rather, an extension of our current efforts. We have no idea as to how much money we will raise via this program but, should the income be subjected to a tax, we will have to consider eliminating the activity from our plan of action. A program that helps the American Kidney Fund, helps the kidney patient, helps the consumer, helps the businessman and helps the card authorizer would be sacrificed because it would, in all probability, not be cost effective. While recent tax legislation has removed the incentive for consumers to use credit cards, the government continues to tax the income of the proprietor for accepting cards and the income of the bank for authorizing cards. It now appears that this is not enough and so it's suggested that we tax charitable institutions for making them available.

Special events have been a part of the philanthropic scene in the United States since the day we became an independent nation. Whether in the form of a dinner to raise funds for a politician, an auction to build a new school house, a concert to support our servicemen here and abroad, or a golf tournament to help needy kidney patients, all such programs have become synonymous with charitable causes. To now say they are unrelated activities denies a very basic principle and challenges the entire volunteer nature of our society.

The American Kidney Fund helps the needy kidney patient to stay alive and to live with a little more dignity. This year we hope to raise in excess of $700,000 through special events. If AKF were assessed 10% of this income ($70,000) as UBIT it would cause us to reduce the number of patient grants made by over 280 (average grant $250). This represents approximately 5% of the total grants we are called upon to fund and would impart a devastating blow to those patients who are dependent upon us as a last resource.

While the leaders of our nation make constant reference to the need for more independent approaches to helping our needy, it seems contradictory to embark upon what is certain to be lengthy and costly discussions of actions that will suppress the commitment of the public to support causes through the spirit of voluntarism that has long been a unique quality of the citizens of the United States.

We urge you to consider very thoughtfully the potential ramifications that implementation of any of the options offered would bring to the non-profit sector and reflect upon what the non-profit sector has already brought to this nation.

Sincerely,

Frank J. Soldovere
Executive Director

COMMENTS OF THE AMERICAN LUNG ASSOCIATION

SUBMITTED BY

JAMES A. SWOMLEY
MANAGING DIRECTOR

The American Lung Association appreciates the opportunity to provide comment to the House Committee on Ways and Means, Subcommittee on Oversight regarding their recently released discussion options for Unrelated Business Income Tax. Before providing specific comments, background on the American Lung Association and its programs is provided to establish the context for the comments.

The American Lung Association is the nation's oldest voluntary health organization. Its mission is the prevention and control of all lung diseases. This mission is carried out through programs in research and training, education of both the public and the health care professional, and public advocacy. Since its founding in 1904 as the organization dedicated to the attack on the major public health problem of that era--Tuberculosis, the American Lung Association has provided leadership in the development of rationale, scientific approaches to combat lung problems of potential catastrophic dimensions.

The American Lung Association is unique among the nation's voluntary health organizations. It is the only such agency with a medical section that is also a recognized medical specialty organization. The Society's 9000 members include physicians, scientists and other highly qualified health professionals. Major activity, in addition to functions as the American Lung Association's medical advisory body, include an internationally recognized annual scientific meeting and the publication of the world's premier journal on lung disease.

Lung diseases constitute a devastating and growing health problem in the United States. Lung diseases range from the chronic and often fatal diseases of the newborn, to serious infectious diseases, to those related to environmental exposure--workplace and ambient air, and to diseases attributable to cigarette smoking--the leading cause of preventable disease in the United States today. An emerging area of concern is the AIDS epidemic--68 percent of all AIDS deaths are due to lung disease, generally opportunistic infections. In 1986, it was estimated that over 83 million Americans, about one-third of the United States population, had chronic respiratory disease, a category including seven conditions ranging in severity from chronic sinusitis to chronic bronchitis and emphysema. In the aggregate, lung diseases, inlcuding lung cancer, ranked third among the leading causes of death and were responsible for 12.5 percent of all deaths in 1984. Chronic Obstructive Pulmonary Disease and allied health conditions are the most rapidly increasing of the top ten leading causes of death between 1970 and 1984. The age adjusted death rate due to lung cancer and COPD increased 35 percent and 36 percent respectively.

Although the statistics present a grim picture, the American Lung Association's programs and collaborative efforts with government and the private sector have improved the nation's lung health outlook. A public health campaign was initiated in the early 1900's by the ALA--then the National Tuberculosis Association. The campaign sought to convince the public that transmission of Tuberculosis, then the nation's number one cause of death, could be prevented by individual and community action. Today, ALA is part of an effort to eliminate TB transmission in the United States by the year 2000. As the 1990's approach ALA has undertaken a major new program initiative, again looking at individual and community action and again going after the nation's current number one killer--smoking. The new program--A Smoke Free Family--builds on ALA's long term commitment to reduce smoking related morbidity and mortality first established in our campaign--"Kick the Habit" begun in the mid 1960's.

A major component of the American Lung Assocation's battle against lung disease is fought in the research laboratory. In addition to a strong research advocacy program which seeks to increase federal funds available for lung research, ALA conducts its own research program. More than 120 research grants were awarded in 1987. A major emphasis of the grant program is to assist young investigators in establishing research careers in lung disease. ALA's research program also recognizes scientists who have devoted their research careers to the causes and cures of lung disease. ALA currently supports 8 "Career Investigators"--a five year funding commitment to each awardee.

The programs of the American Lung Association happen because of public support.

ALA's major fund raising activity is the annual Christmas Seal Campaign, now entering its 81st year. The Christmas Seal Campaign is supplemented by a variety of so-called special events and corporate sponsorships. This fund raising activity is conducted soley for the support of the broad range of education and research activities related to achieving ALA's mission.

The American Lung Association understands the broad concerns the Subcommittee has with the Unrelated Business Income Tax and its intentions to develop recommendations to regulate further the activity of nonprofits which seek to raise tax free dollars through participation in business activity unrelated to their tax exempt purpose. ALA acknowledges the need for such action and believes such income should be taxed. For example, ALA, rightfully, continues to report, for purposes of the Unrelated Business Income Tax, the income generated from advertising in its medical journal, The American Review of Respiratory Disease. Our concerns with the Subcommittee discussion options relate to the expansion of Unrelated Business Income categories and the use of vague and ambiguous language to define these new areas of coverage. ALA believes that the Subcommittee should consider more effective application and enforcement of current authority to address the problems identified in its June 1987 hearings rather than the options for taxing now-exempt activity. In general, ALA opposes the repeal of the "substantially related" test which determines whether an activity that produces income for an organization is taxable. Further, ALA opposes the proposals to tax fund raising and program activity and the option regarding the taxation of passive income tax exempt organizations derive from royalties. These options, if enacted into law, would severely restrict ALA's fund raising activity with a corresponding impact on our ability to deliver programs to the public for the prevention and control of lung disease. Below are the American Lung Association's specific comments on the discussion options.

o **Substantially Related Test**

It is important to note at the outset that during the Subcommittee hearings the Internal Revenue Service and the Small Business Administration did not recommend the repeal of the "substantially related" test. The Small Business Administration did recommend, however, the further definition of "substantially related" activities. The American Lung Association recognizes application of this standard by the Internal Revenue Service has been broad and many organizations have further added to the situation by use of a liberal interpretation of the test.

The alternatives put forward in the Subcommittee's discussion options are vague and the distinctions unclear. The differences in assessing support for "substantial" versus "direct" is dependent upon their definition. Current law requires a strong connection between the activity and the exempt purposes of the organization for exemption. The current test also requires a "causal relationship" to the organization's charitable purpose and must "contribute importantly" to achieving those purposes. Without proper definition, it is unclear how a "direct" test would differ from the current "substantial" test. The American Lung Association views the option of determining whether each income producing activity standing alone is tax exempt in a similar framework. The option is not significantly different from current practice.

The American Lung Association has major objections to the third option within this category, that of retaining the current test of "substantially related" but including taxation of "specific inherently commercial" activity. No information is provided as guidance for determining how "inherently commercial" might be defined, rather a series of limitations is proposed. This option would result in major changes in many areas of activity and would significantly limit current exemptions--income producing activity for the nation's charities such as the American Lung Association. Such action would also impact other activity which provides direct support for major program initiatives. The American Lung Association's specific comments on the proposed limitations include:

Catalog and Other Mail or Phone Order Sales

No definition is provided to assess how this option might be implemented and which activity would be covered. The American Lung Association is concerned that several of its program support activities might fall into this category of coverage without careful consideration of an appropriate definition.

For example, the American Lung Association maintains a "Supply Service" which has as its primary purpose the sale and distribution of a range of program education and fund raising materials produced by the ALA, and services to its 134 local and state offices. The "Supply Service" operation is offered to our local and state offices for the convenience of the economies of bulk purchasing. Without knowing how this test would be applied, ALA is concerned that the income derived from the service now utilized to upgrade and expand the service would become taxable income rather than income available for support of the program activity.

Medical Equipment, Laboratory Testing and Pharmaceuticals
No definition is provided to assess how extensively this option would be applied. Again, the American Lung Association is concerned that inappropriate application may severely impact its current programming initiatives.

For example, the ALA's medical section, the American Thoracic Society, manages a program to provide standardized testing for laboratories engaged in arterial blood gas analysis. The program is provided to enable laboratories to develop and maintain high standards for the conduct and interpretation of such tests which are essential to the management of patients with severe lung diseases. It is unclear from the language provided by the Subcommittee whether the intent is to apply the tax to the test conducted by a laboratory or the testing of laboratories for quality control purposes.

Travel Services
This provision would tax certain tour and related activity. Again without clear language as to the application of the proposal, it is difficult to assess the impact upon activity of the American Lung Association. A concern we would have relates to a special fund raising event--the "Trek" program. This program provides the opportunity for individuals to make charitable contributions to the American Lung Assocition while engaging in a variety of outdoor activities. This summer for example, ALA will sponsor the second annual TransAmerica Bike Trek, a biking tour across the United States in which the riders secure pledges of support for miles ridden. ALA is concerned that a broad interpretion of travel services would severely impact a significant source of income which is derived from charitable gifts. Of further concern are options under consideration that would consider income derived from the pledges as fees subject to taxation--clearly individuals pledging support during such an event do so as a charitable gift.

Affinity Credit Cards and Catalog Endorsements
The definitions and scope of this option are critical in terms of its application. It is quite proper, in ALA's opinion, to tax charities when they compete with a commerical activity. The use of affinity credit cards, catalog sales and other corporate promotions can achieve success only because a donor chooses to do something beneficial for a chosen charity and therefore, should not be treated as Unrelated Business Income for tax purposes. Without a conscious action on the part of an individual there would be no income to the charity.

Advertising
Advertising is currently taxed only if the publication earns an overall profit. The proposal would subject all income from advertising to the Unrelated Business Income Tax and only direct costs of advertising would be deductible. The American Lung Association currently reports, for the purposes of the Unrelated Business Income Tax, on its journal, The American Review of Respiratory Disease. However, further changes in the application of Unrelated Business Income Tax to advertising could have a significant impact in other program support areas such as activity related to announcing the organization's annual scientific meetings. Without proper definition of commerical advertising, it is unclear how broadly such a proposal would be applied.

o Regularly Carried On Test
Among activities currently exempt by the "regularly carried on" test are a variety of fund raising activities. Further, income from advertising related to conventions is generally exempt under this test.

The American Lung Association is especially interested in this option. An annual black tie event is held annually to generate funds for the support of the organization's research program. Because, in general, only modest activity is needed to meet the trade or business requirement, the standard would be met by most income producing activity. ALA would encourage the Subcommittee to continue exemptions for galas and similar events since they do not constitute a business activity.

Royalty Exclusion
Under current law all income that is legally classified a royalty is exempt from the Unrelated Business Income Tax. The Subcommittee proposes to deny the exemption to royalties based on the net income. The American Lung Association believes that broad application of the proposal could be potentially expensive to it. ALA has developed royalty income based on the use of its name and good will. This is strictly an effort to use the support that individuals want to give to charity for specific program activity. It appears inappropriate to put a tax on a charity's good name and good works.

The Subcommittee proposes to continue exemptions for "certain nonworking property interests". The scope of the concept of "property created" by an exempt organization is not adequately defined and therefore, the unclear language again makes this proposal difficult to assess.

STATEMENT

of the

AMERICAN MEDICAL ASSOCIATION

to the

Oversight Subcommittee
Committee on Ways and Means
U.S. House of Representatives

RE: Unrelated Business Income Tax

April 15, 1988

The American Medical Association (AMA) is a professional association comprised of approximately 250,000 practicing physicians, academics, residents, interns and medical students. In recognition of the Association's purpose, the AMA is generally exempt from income tax under Section 501(c)(6) of the Internal Revenue Code of 1986 ("Code"). The AMA is subject to tax on its income from unrelated business activities. The AMA believes that the long-standing practice of granting tax exemption to not-for-profit organizations whose activities benefit the public has well served the public interest.

Among the long-standing purposes of the AMA are the advancement of medical knowledge and the betterment of the public health. A list of our activities which serve the public interest and assure quality medical care through information dissemination, conferences, publications, public health initiatives, and accreditation and credentialing services is attached to this statement. These beneficial activities provide the basic rationale for the existence of professional associations such as the AMA, and would be impossible for the AMA to finance through voluntary dues alone. Our ability to carry on many of these programs for the betterment of the public is partially dependent on our business income; an increase in income taxes would divert resources from these activities having a correspondingly adverse effect on our ability to provide these services. Faced with substantially higher taxes, we would be forced to reduce our many activities that benefit the public health and welfare.

The AMA agrees that net income from commercial activities should be subject to tax whether or not the activities are conducted by otherwise tax-exempt organizations. The AMA is subject to UBIT and does pay tax on our unrelated business activities. However, a number of principles are implied in the decision to tax unrelated business income. First, only income from commercial activities, as opposed to portfolio income, should be taxed. Second, although income from commercial activities is properly subject to tax, the mere conduct of such activities should not constitute a basis for denying an exempt status for an organization. Third, the income which is subject to tax from commercial activities should be computed in the same manner for all organizations -- commercial firms and tax-exempt organizations.

The AMA has serious concerns that a number of the discussion options released by the Subcommittee on Oversight violate these fundamental principles. Specifically, some options would in the case of royalties, subject mere portfolio income to a tax otherwise applicable only to business income; deny tax exemption to organizations on account of their ownership of commercial enterprises even though the latter's income is fully taxed; and establish a series of rules for computing taxable income that would apply only to exempt organizations and would seriously overstate their income subject to tax.

Following a series of hearings on the unrelated business income tax law (UBIT) last summer, the Subcommittee has now released preliminary discussion options relating to the tax. According to the Chairman, "the discussion options are not specific recommendations, but serve as the generally agreed to starting point for the Subcommittee discussions." The Chairman also stated that he looked forward to constructive and detailed comments by all interested parties. With this in mind, the AMA offers the following comments on selected discussion options set forth by the Subcommittee.

1. Discussion option: Apply the unrelated business income tax to (a) royalties measured by net or taxable income derived from the property, or (b) royalties received by an organization for use of property if such organization, or a closely related organization, either created the property or performed substantial services or incurred substantial costs with respect to the development or marketing of such property.

True royalties received by exempt organizations have never been subject to federal income tax. To the extent that this option is intended to describe income which is denominated as a royalty but which as an economic matter is income from participation in a commercial activity, this option is consistent with this long history and the principles underlying the unrelated business income tax. Royalties from net income are analogous to profit shares, and thus could be taxed as business income consistent with these principles. However, taxing income merely because the exempt organization created the licensed property in the course of carrying out its exempt activities cannot be justified by the claim that business income is being taxed. Such income is mere portfolio income and taxing it would repeal the basic tax exemption for reasons having nothing to do with the rationale underlying the unrelated business income tax.

2. Discussion option: Aggregate income and activities of controlled subsidiaries for purposes of determining if the primary purpose of the parent organization is a tax-exempt purpose.

This discussion option would constitute a serious departure from the long-standing principle that corporations and their stockholders are discrete persons and that the activities of one are not attributed to the other. This principle is found throughout the tax law and should be followed unless there are compelling reasons for not doing so. Among the implications of adoption of this option would be a re-examination of the meaning of the primary purpose test, whether that test turns on volume of activities, and whether the ownership and operation of fully taxed commercial enterprises as divisions of an exempt organization is in any way inconsistent with the organization's tax exemption.

In his testimony before this Subcommittee, Assistant Treasury Secretary Chapoton stated that aggregation of exempt organizations and their commercial affiliates might be considered, but only in "appropriate cases." He alluded to situations in which the personnel of the exempt parent spend excessive amounts of time on the operations of the commercial subsidiary and suggested that this could occur if the management of the subsidiary is fully integrated with that of the exempt parent. In many cases, however, the subsidiary has separate management and the parent's personnel spent little, if any, time on the subsidiary's operations. In such situations, the exempt organization is primarily an investor which can obtain income from its investment in the subsidiary while its own personnel and activities remain devoted to its exempt purposes.

We strongly recommend that the Subcommittee not adopt a rule which calls for aggregation based solely upon ownership of a certain percentage of stock. This would deter organizations from making investments which in no way undermine their exempt purposes or constitute any type of abuse. Instead, a remedy more targeted to the perceived abuse should be devised.

3. **Discussion option: Allow an exempt organization to deduct only direct advertising costs from advertising income. The excess of readership costs over circulation income would no longer be deductible.**

The AMA opposes this proposal. The Journal of the American Medical Association (JAMA) is the most widely read scientific clinical journal in medicine, while American Medical News (AMNews) is the best-read medical publication overall.

JAMA and the AMA's nine specialty journals reach more than 600,000 readers, providing peer reviewed scientific information on developments affecting the practice of medicine to a worldwide audience of physicians. The significant impact of the scientific contributions of JAMA is illustrated by the frequency with which the content of JAMA becomes major news on the television networks, and in newspapers and magazines throughout the country. This editorial content is made possible in part through subscription revenue and in part through advertising revenue. The AMA pays unrelated business income tax on the advertising revenues generated by our publications, after deducting that portion of the editorial costs that are not covered by subscription revenue.

The primary purpose of the UBIT is to tax unrelated business income of exempt organizations on the same basis as income of taxable businesses. This discussion option would deny exempt publications legitimate deductions which are available to commercial publishers. Its adoption would thus subject publications of exempt organizations not to equal but to greater taxation.

In its testimony before the Subcommittee on June 29, 1987, the Association of Business Publishers claimed that a change in the way advertising income is taxed is necessary because the current rules allow exempt organizations, including the AMA, to use "sophisticated accounting tax avoidance devices" to report "artificially low" circulation income from members. This assertion is simply untrue. The AMA determines "allocable membership receipts" in accordance with IRS regulations designed to put exempt and taxable publishers on an equal footing so far as taxes are concerned.[1] The amount allocated varies somewhat from year to year, but is many times the amount suggested by the Business Publishers.

The AMA does not believe that the current rules result in allocation of inadequate amounts of membership dues to circulation income. Even if this were the case, however, the correct solution would be to revise the regulations to provide for appropriate allocations, not to deny exempt organizations legitimate deductions necessary to keep them on an equal tax basis with commercial publishers.

4. **Discussion option: Disallow deductions for depreciation and overhead with respect to facilities used both for exempt and commercial purposes.**

It has been suggested that depreciation and overhead costs are not properly deducted from unrelated business income because these costs would be incurred by the exempt organization regardless of whether it engaged in an unrelated business. In fact, exempt organizations often build a facility with the intention of covering some of the fixed costs of the facility with income derived from commercial uses. Our ability to afford a facility may depend on commercial uses. In these cases, depreciation of the facility is not entirely a cost which would be incurred regardless of whether the organization engaged in the unrelated business.

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[1] The AMA is currently involved in litigation with the IRS regarding the interpretation and validity of certain portions of these regulations. The AMA does not, however, disagree with the purpose of the regulations or the principle that a fair amount of dues income should be allocated to circulation income, and believes that its interpretation of the regulations achieves these objectives.

In the case of the AMA, we would be hard-pressed to maintain the quality of our journals because physical facilities, data processing capacity, and administration are "dual use" in that these facilities serve the exempt editorial function as well as the non-exempt advertising function.

The practical difficulties of assessing the reasonableness of these deductions in some cases should not justify denying the deduction. Any difficulties can be alleviated by means less drastic than prohibiting the deductions entirely. For example, the burden could be placed on the exempt organization to prove, through credible evidence such as time logs and other appropriate records, that a portion of a facility was used for, or a portion of a staff member's time was spent on, non-exempt activities. Such a requirement should allay the Treasury's fear that organizations could use imprecise allocation rules to "zero out" their unrelated business income.

In short, potential abuses can be foreclosed without resorting to an option that would overstate, perhaps significantly, the taxable income of exempt organizations.

5. **Discussion option: Define "control", for purposes of Section 512(b)(13), as ownership by an exempt parent, directly, indirectly, or by attribution, of at least 50% of the stock of a taxable subsidiary, measured by vote or value.**

The current definition of "control" used to determine whether interest, annuities, rents and royalties paid to an exempt parent by its controlled subsidiary are taxable under Section 512(b)(13) is a rigid definition which defines control as ownership of 80% the voting power of voting stock and 80% of each other class of stock. No attribution rules are used to determine ownership. In some cases, exempt organizations have been able to establish taxable subsidiaries which are not controlled subsidiaries under the technical definition of "control," but which are clearly controlled by the exempt organization in any practical sense.[2]

If the current control definition may be so easily manipulated, it should be replaced. The proposed definition is similar to those of Sections 267 and 304(c). These definitions look to practical control and, unlike the definition currently used, can not be easily avoided. The proposed definition of control has a further advantage in that it is based upon statutory rules of long standing with a body of well-developed administrative and judicial precedents which will assist both the IRS and the exempt organizations in administering the rule of Section 512(b)(13).

6. **Discussion option: Provide that a controlled taxable subsidiary's taxable income can be no less than unrelated business taxable income would have been if the income producing activity had been carried on directly by the exempt parent organization.**

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[2] For example, Ltr. Rul. 8414001 involved an exempt organization which organized a taxable subsidiary to acquire and operate a business concern. The exempt organization owned all of the subsidiary's common stock, but an individual who was a member of the exempt organization's governing board owned an issue of nonvoting, nonparticipating an nonconvertible cumulative preferred stock. The Internal Revenue Service concluded that the subsidiary was not controlled by the exempt organization. As a result, interest received by the exempt organization from the subsidiary escaped the application of Section 512(b)(13).

The purpose of this discussion option is to prevent perceived abuses such as that in the example contained in this discussion option, in which an exempt organization can reduce or eliminate its unrelated business taxable income by putting both a profitable unrelated business activity and an unprofitable activity which is related to the organization's exempt purpose into a taxable subsidiary. Clearly such a scheme should not be tolerated. We believe that there are adequate provisions in current law to prevent such abuses, such as rules that disallow losses on activities not engaged in for profit and that grant the Internal Revenue Service authority under Section 482 to reallocate income and deductions between entities under common control. Therefore, no statutory provision to address these abuses is necessary.

7. **Discussion options: Require affiliated groups which include an exempt organization to file a consolidated information return; recommend that the IRS conduct integrated audits of exempt organizations and taxable subsidiaries; and audit exempt organizations which do not file 990-T Forms.**

The Subcommittee is considering a number of options regarding enforcement of the unrelated business income tax. These include requiring an affiliated group which includes an exempt organization to file a consolidated information return, recommending that the IRS conduct integrated audits of exempt organizations and taxable subsidiaries, and increasing audits of exempt organizations which do not file 990-T Forms. The AMA supports these proposals.

The current lack of information regarding unrelated business income tax compliance by exempt organizations was forcefully brought home to the Subcommittee at its hearings last summer. We believe that the Internal Revenue Service has moved in the right direction by undertaking a taxpayer compliance measurement program (TCMP) survey of unrelated business income tax issues. The IRS also indicated that it was selecting statistical samples of unrelated business tax returns and other relevant data to develop interim information for structuring the TCMP and to improve the selection of returns for examination. The AMA (which is audited on each of its returns) strongly endorses efforts by the IRS to improve the compliance of exempt organizations with the existing code requirements.

CONCLUSION

Finally, after discussing exempt organizations in terms of their business revenues and tax liabilities, we would like to turn the Subcommittee's attention to the other side of the ledger - the important public benefits that accrue to the citizens of this nation as a consequence of our activities.

The American Medical Association will continue to pay its fair share of taxes on unrelated business activities, but we appeal to the Subcommittee to refrain from overly broad responses to UBIT abuses. Changes in UBIT must be carefully tailored so that competition and tax revenues are not increased at the expense of beneficial public programs provided by exempt organizations such as the AMA.

3669p

The following activities are a partial listing of American Medical Association projects which serve the public interest.

SCIENTIFIC INFORMATION

- One of the Association's greatest strengths is its ability to collect and disseminate scientific information of recognized value to the profession and the public. The AMA's programs are directed toward the development and dissemination of such information throughout the world by technologically-advanced means.

- A number of conference, course and seminar-related activities will be offered in 1988 by the AMA. These include:

  - Adolescent Health Congress
  - Biotechnology Conferences--
    - DNA Probes in the Practice of Medicine
    - Existing and Developing Regimens for AIDS
  - National Conference on Health Education Needs in AIDS
  - Physician Support Conference (Impairment)
  - Continuing Medical Education Courses
  - Section on Medical School Programs, e.g., Conference - April 7-9, 1988; Physician Competence: Whose Responsibility?
  - Fast-tracking treatment IND (Investigational New Drug) for Critically-ill Patients Conference
  - Video Clinics - HSN Video Conference (Hospital Satellite Network)
  - Medicine in the 21st Century: The Future of Biomedical Research
  - Adolescent Health: The Role of Corporations, Foundations, and Government (Duke - AMA Conference)

- The AMA also publishes books and other publications to disseminate scientific information to the health care community and to the general public:

  - Handbook on Poisonous and Injurious Plants
  - AMA Drug Evaluations (Sixth Edition)
  - PMI Sheets (Patient Medication Information)
  - AIDS and Adolescent Health Education Materials
  - The Health of Adolescents (Text produced under contract)
  - Guides to Evaluation of Permanent Impairment
  - AIDS From the Beginning, and other publications from JAMA
  - Allied Health Education Directory, Newsletter, and Fact Sheet
  - Future Directions for Medical Education
  - Handbook on Alcoholism and Drug Abuse
  - White Papers on Animals in Research and Dilemma of Young Clinician Researchers
  - Proceedings of the International Conference on Non-Military Radiation Emergencies

- The AMA library provides scientific, medical, and socioeconomic information to the AMA, the profession, and the general public. These activities include reference services such as on-line literature research; the establishment and maintenance of automated and technical library services; and the provision of special support services needed to fulfill medicine's unique information requirements.

- Public health is a major priority of the Association, which disseminates public health information on these topics:

  - AIDS Activities
  - Adolescent health
  - Health Risks of Radon

- American Medical Association -
Department of Federal Legislation, Division of Legislative Activities

- Emergency Planning for Radiation Accidents
- Elder Abuse
- Information on licensure, certification
- Impaired Physician Programs
- Animals in Biomedical Research
- Toxicology Database
- Child Abuse
- First Aid
- Evaluation and Accreditation of Allied Health Education Programs

ACCREDITATION — MEDICAL EDUCATION AND ALLIED HEALTH PROGRAMS

The AMA's accreditation activities in medical education and allied health form the bedrock of confidence that the public and the profession hold in the competence and reliability of physicians. These activities contribute to medical education by providing administrative and professional evaluation support to the Accreditation Council for Graduate Medical Education (ACGME). Residency Review Committees, which are jointly sponsored by the AMA and other organizations, are responsible for maintaining uniformly high standards of graduate medical education in more than 5,000 residency programs throughout the United States. Other projects involving medical education include the following:

- Allied Health Education Evaluation and Accreditation (CAHEA)
- Medical Education Issue of JAMA
- Medical School Visitation Program
- AMA Educational Research Foundation
- International Medical Scholars Program
- Foreign Research Trainees
- Medical Education Information and Analysis
- Medical Education Electronic Bulletin Board
- Future Directions in Medical Education
- Directory of Graduate Medical Education
- Medical Education Research
- Commission on Quality Assurance in Medical Education
- Computerized Graduate Medical Education Data Base

PHYSICIAN CREDENTIALING

- AMA maintains a unique "Masterfile" on all U.S. physicians and, as a function of this activity, is in a position to identify individuals with less than complete credentials, and/or those physicians who have been disciplined by state medical boards and federal agencies such as the military. AMA makes every effort to inform the medical community and investigative agencies as necessary when such information surfaces.

- An estimated 250,000 Physician Profiles are provided annually to the medical community by AMA for use in the credentials screening process. For years, the AMA has provided this service to hospitals, licensing agencies, and other medically-related organizations for the purposes of strengthening the physician credentialing process in the U.S.

- The AMA has assisted the Armed Forces, the Veterans Administration, and the Public Health Service in checking their physicians' credentials. Some 120,000 physician records have been provided to these public sector agencies.

- AMA automatically alerts state licensing boards of actions taken by other boards when AMA records indicate that the physicians involved are holding or have held multiple state licenses, the purpose being to alert states to the possibility of a sanctioned physician jumping from one state to another and continuing to practice. On average, "Licensure Action Alert Letters" on some 60-70 disciplined physicians are sent by AMA each month to state licensing boards.

- AMA, on numerous occasions, has been instrumental in the removal of unqualified individuals from residency training programs in the U.S. through a program of cooperation and information sharing between AMA, the Educational Commission for Foreign Medical Graduates (ECFMG) and some 7,000 accredited residency training programs in 1,000-1,500 teaching hospitals. AMA has assisted ECFMG in the Commission's reexamination of the credentials of some 3,000 individuals from schools in the Dominican Republic. The whereabouts of these individuals were provided to ECFMG from the AMA Physician Masterfile.

- AMA, repeatedly, has cooperated with the United States Inspectors General, the Federal Bureau of Investigation, Postal Service Investigators, and other law enforcement agencies in efforts to curb fraud and abuse in the Medicare/Medicaid programs and illegal trafficking of medical credentials.

- AMA is providing state licensing boards reports on deceased physicians going back to the late 60's and early 70's. Information on approximately 70,000 deceased physicians is available to the boards for use in preventing individuals from using deceased physicians' credentials to establish themselves in practice.

American Numismatic Association

WORLD'S LARGEST ORGANIZATION FOR COLLECTORS OF COINS, TOKENS, MEDALS & PAPER MONEY

Chartered by the Congress in 1912

Written In Our 97th Year

April 12, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight,
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman:

I am writing to you and your fellow committee members in response to your request for public comments on the Discussion Options under consideration regarding Unrelated Business Income Tax (UBIT) for non-profit organizations. As you are assuredly already well aware, private non-profit organizations in our country--museums in particular--depend heavily upon the financial support of their respective constituencies, both the audiences served as visitors to their facilities and those for whom they provide extra-mural resources and special services in keeping with their institutional purposes. With the broad independence granted to and expected of charities under our system of government, this is as it should be.

Recently, of course, non-profit organizations have awakened more fully to the benefits of rigorous corporate accountability and administrative practices in keeping with advances in the private sector. This has been a result both of greater professionalism in the field and of increasing needs to utilize legitimate sources of private funding in a context of decreasing corporate and governmental support. The 1986 income tax revisions have, futhermore, diminished the advantages for donors in making charitable contributions to eligible non-profits.

Taxing non-profit organizations on income generated from the performance of their established institutional objectives risks considerable damage to many desirable activities in our society. While it may be true that there have been instances of abuse, would it not be better to right any specific wrongs than to make wholesale

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changes that would be potentially hurtful to those museums, and other non-profit organizations, that contribute so much to the cultural and educational life of our country? I do not feel that the proposed UBIT modifications are what Congress truly wants; I am convinced they are not what our people will want when they are fully presented with the issues involved.

I can speak on behalf of the American Numismatic Association in saying that the proposed changes in taxation for souvenirs, books, catalog orders and royalties would have an adverse impact on our ability to serve our membership (about 35,000) and the public with educational programs. The ANA, operating uniquely under a charter granted by Congress, is the world's largest organization dedicated to fostering awareness and appreciation of the collecting and studying of coinage and related materials--as a pastime and as a scientific record of civilization's achievements.

Our mandate is to serve all those who share such interests, in particular those who do not otherwise have ready access to numismatic resources. Our library, for instance, loans references by mail to all members, and is the largest such circulating library in existence for this field. Our revenues, of whatever nature, are expended in the fulfillment of our congressionally chartered goals. Consequently, we feel strongly that any measures which curtail our ability to serve are counterproductive.

At this juncture in history, when many museums are striving to be more self-reliant and efficient, while the national government is looking to have other sectors shoulder social responsibilities as much as possible, the idea of crippling a portion of the supporting framework for educational and charitable organizations seems not to be the better part of wisdom.

Sincerely yours,

Robert J. Leuver
Executive Director

RJL/slb

COMMENTS OF R. WILLIAM TAYLOR, CAE

PRESIDENT,
AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

SUBMITTED TO THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT,
REGARDING DISCUSSION OPTIONS ON THE UNRELATED BUSINESS INCOME TAX

April 15, 1988

The American Society of Association Executives (ASAE), Washington, D.C., is an individual membership society representing more than 16,000 executives who manage some 7,000 trade and professional associations in the United States and abroad.

ASAE appreciates the Oversight Subcommittee's review of the unrelated business income tax (UBIT), and welcomes this opportunity to comment on the discussion options now under consideration. The Society testified during the Subcommittee's UBIT hearings last summer, and continues to have great interest and concern in the deliberations. These comments are intended to assist the Subcommittee in developing UBIT recommendations that are fair and appropriate to the tax-exempt community.

At the outset, ASAE believes that nonprofit organizations have been accorded tax-exempt status in recognition of the valuable role they play in society. The vast majority of trade and professional associations continue to fulfill this public policy mandate and are justifiably tax-exempt. Inappropriate and unnecessary changes in the UBIT statute would have a profound negative effect on these organizations. Therefore, ASAE supports "fine-tuning" of the existing statute, along with strict IRS enforcement of the current rules.

One option proposed by the Subcommittee is repeal of the "substantially related" test, to be replaced by a "directly related" test. A second option is to determine, on a case-by-case basis, whether income-producing activities of nonprofit organizations should be tax-exempt. A third option is to retain the "substantially related" test, but impose UBIT on specific activities deemed to be "inherently commercial."

In this regard, ASAE agrees with O. Donaldson Chapoton, the Treasury Department's Deputy Assistant Secretary for Tax Policy, who testified last summer that the "substantially related" test provides a sound basis for granting exemption from tax. Furthermore, ASAE concurs that the standard would be difficult to improve upon and that no changes are needed at this time.

We also agree with Treasury's view that "efforts should focus instead on obtaining more detailed information concerning the revenues of exempt organizations and the basis for treating them as tax-exempt...Such additional detailed reporting could provide the basis for better enforcement and compliance as well as for a more informed evaluation of the adequacy of the relatedness test." In this light, ASAE fully supports the Oversight Subcommittee's proposals designed to gain additional information on nonprofit organizations' income producing activities, especially through IRS Forms 990 and 990-T. As stated in our testimony last summer, ASAE believes that administration of the UBIT statute can and should be improved. The IRS should strictly enforce current UBIT rules, audit more returns, and provide more accessible information in order to improve the tax-exempt community's understanding of the statute. Compliance (and therefore federal revenues) would undoubtedly increase as a result.

Of the twelve options suggested by the Subcommittee to limit ostensibly "commercial" activity, ASAE would like to comment on Item J, which proposes to "apply UBIT to advertising income and allow deductions from UBIT only for direct advertising costs." In appraising this option, it should be noted that nonprofit organizations' advertising revenue is currently taxable if and when the given publication earns a net profit. In such case, an organization may seek to reduce its taxable income by allocating costs related to advertising against income. The specific allocation procedures are complicated; however, they allow nonprofit publishers to compete on an equal basis with their for-profit counterparts. The Subcommittee's proposal to disallow a deduction for indirect advertising costs (i.e. expenses related to the publication's production and overhead) would penalize nonprofits without affirmatively addressing complaints of "unfair competition" raised by for-profit organizations.

Furthermore, a major purpose of trade and professional associations is to provide their members with relevant and timely information. Publications are an integral part of this process. Advertising in association journals is at least as important a service to the reader as editorial content, and is so considered by members. The Subcommittee's proposal would have a significant negative impact on association publications, to the detriment of members as well as the organization itself. In ASAE's view, this option represents the wrong approach in attempting to make the tax treatment of exempt organizations more uniform and fair.

Similarly, ASAE must take issue with the Subcommittee's option to apply UBIT to royalties. The proposal fails to recognize the extent to which these activities contribute importantly to the accomplishment of a nonprofit organization's exempt purpose. In almost every case, royalties represent passive income which the organization then uses to fund its member services and other programs. Many groups (including ASAE) also use such funds to build a reserve for future growth, as well as for their survival during economic downturns. These practices are certainly appropriate, since nonprofit groups do not have private owners or stockholders for capitalization. The only way they can build stability and security is to spend less than they take in.

Additionally, royalties are not generated by any activity in competition with taxable businesses. The application of UBIT to such income would constitute an unjust and unnecessary penalty on a legitimate nonprofit organization activity. Since the taxation of royalty income would not raise any significant revenue, ASAE can see no justification for this particular option.

On the other hand, ASAE would support the Subcommittee's proposal to increase the deduction from UBIT to $5,000 or $10,000 to ensure that nonprofit organizations with minimal unrelated business income would not be affected by the tax. This was recommended by the Treasury Department in its testimony last summer, and received ASAE's endorsement at that time.

With regard to the Subcommittee's proposals concerning exempt organizations' taxable subsidiaries, ASAE questions the first option to reduce the stock ownership required for control from 80 percent to 50 percent. The purpose of current law in this regard is to prevent tax-exempt parent organizations from dictating unreasonably high payments to their subsidiaries, thereby reducing the taxable income of the subsidiary at no cost to the parent. Since there is no evidence that organizations are abusing their "arms length" relationship with subsidiaries, this proposal seems unnecessary. Its effect would be to tax income (e.g. rent, interest or royalties) that is no different than payments received from outside third parties.

ASAE also has particular concern about the fourth option, which would "aggregate income and activities of controlled subsidiaries for purposes of determining if the primary purpose of parent is a tax exempt purpose." This proposal effectively ignores a salient fact about modern tax-exempt organizations: while they do not operate principally to earn a profit, revenue must be produced to furnish member services and advance exempt purposes.

In many cases, tax-exempt organizations will form taxable, separately incorporated subsidiaries where a given activity is partly related and partly unrelated to an exempt purpose, or where it may entail significant liability exposure. ASAE believes such situations generally warrant the establishment of a taxable subsidiary. However, the Subcommittee's option to attribute the income and activities of a subsidiary to its controlling organization is, in our view, unnecessarily harsh. The proposal would cause uncertainty about the relationship between tax-exempt organizations and their subsidiaries. It could also mitigate against the creation of the latter. ASAE believes that the tax-exempt community should not be discouraged from creating taxable subsidiaries where the income produced contributes importantly to the exempt purpose of the parent organization.

Finally, ASAE cannot support certain other options that would modify or repeal "piecemeal UBIT exclusions," including testing for the public safety and income from conventions, exhibitions and trade shows. In our estimation, all these activities are clearly related to an exempt purpose and provide an unmistakeable benefit to nonprofit organization members as well as the general public. For instance, nonprofits conduct routine testing which is essential to the public safety. Also, trade show activities are integrally tied to a tax-exempt organization's ability to serve its members. We believe that such exclusions from UBIT are well worth maintaining.

In sum, ASAE welcomes the Subcommittee options as a starting point in determining the appropriate tax treatment of nonprofit organizations. While we view several of the proposals favorably, we must take issue with others that appear to be discriminatory, excessively burdensome, or which belie the fundamental nature and role of tax-exempt organizations in American society. ASAE wishes to reiterate that precipitous, radical, or unwarranted changes in the UBIT statute would penalize all nonprofits, instead of those engaged in activities clearly peripheral to their tax-exempt purpose. Based on all available evidence, such cases appear to be few and far between. ASAE therefore supports enforcement of the UBIT statute in approximately its current form.

ASAE hopes these comments will be helpful to the Oversight Subcommittee as it attempts to reach a consensus on appropriate changes to the UBIT statute. We appreciate the Subcommittee's diligence in this area, and look forward to supplying additional information and comment as its recommendations are developed.

American Society of Travel Agents

April 15, 1988

The Honorable J.J. Pickle
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515-4310

Dear Representative Pickle:

The American Society of Travel Agents, Inc. (ASTA) applauds you, Mr. Chairman, and members of the House Subcommittee on Oversight for holding hearings to review the issue of Unrelated Business Income Tax (UBIT) and for focusing on the federal tax treatment of commercial and other income-producing activities of organizations that have tax-exempt status under Section 501 of the Internal Revenue Code.

It is clearly an emotionally charged issue as evidence at the extensive five days of hearings in June 1987. It is also a confusing one, since data about the commercial activities of non-profits are inaccurate and incomplete. Nevertheless, the issue continues to have a severe economical impact on the tax-paying travel agent community.

The preliminary discussion options released by the subcommittee reveals its serious intent to recognize UBIT as an issue and its willingness to begin procedures to formulate constructive solutions to rectify the abuses. The subcommittee staff should also be complemented for their effort in putting forth these recommendations which are a good starting point for this highly controversial and sensitive issue.

ASTA
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ASTA believes the analysis of the "substantially related" test goes to the crux of the issue. However, ASTA strongly supports the principal that UBIT should be imposed on those specified activities whose very nature and scope is inherently commercial rather than charitable. We would support applying this rule to all activities listed in the discussion options under Section I. A through J as long as stronger enforcement is implemented by the Internal Revenue Service.

Under Section I. D -- Apply UBIT to travel and tour services (with exception for services provided by colleges/universities to students/faculty as part of a degree program curriculm, and de minimis sales to non-students/faculty.) ASTA does not agree that de minimis sales exemption should be applied for non-students and faculty who purchase travel and tour services. ASTA supports exemption for a degree program curriculum. Although, we do foresee a tremendous challenge on the part of colleges and universities not to offer curriculum sponsored travel programs to the general public. This will become prevalent when the cost factor for the sponsored program is determined by volume.

Over two-thirds of ASTA members are small business travel agencies having an annual volume of gross sales of less than $2 million. The travel industry is the nation's third largest retail industry in business receipts. Over $269 billion was spent on travel and tourism in 1986 alone -- representing over 6% of the Gross National Product and rising at a rate of 10% annually and a full 6% increase over the previous year. Consequently, many organizations want to reap the financial rewards from the sale of travel and travel services.

Tax-exempt and federally funded organizations are no different. Additional revenues are gained by selling travel otherwise, they would not engage in this type of commercial activity.

ASTA continues to support its testimony submitted on June 25, 1987. We also hope serious consideration will be given toward the position taken on Section I.D.

Once again Mr. Chairman, we congratulate you and your subcommittee for its efforts on this issue and request that any measures taken on UBIT be completely separate from any legislative effort currently underway. UBIT considerations should be dealt with by the full committee on its own merits.

Sincerely,

Earlene L. Causey

Earlene L. Causey
Chairman
Fair Competition Committee

ELC/mm

April 14, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Unrelated Business
Income Tax

Dear Mr. Leonard:

Thank you for the opportunity to comment on options relating to the Unrelated Business Income Tax (UBIT). The American Speech-Language-Hearing Association (ASHA) represents 56,000 speech-language pathologists and audiologists nationwide who work in a wide variety of settings, both for profit and nonprofit.

Much of the current debate concerning the dispensing by nonprofit organizations is focused on hospitals, university speech and hearing clinics where audiologists-in-training receive their clinical experience and community-based speech and hearing centers which employ audiologists.

Our members are concerned about (a) the focus of the activities of the Subcommittee on Oversight on hearing aids, (b) the effect of these proposals on non-profit hospitals, nursing homes, rehabilitation agencies, home health agencies, community non- profit agencies and university training centers, and (c) the effect on 501(c)(6) organizations - associations - such as our own.

While there are some areas specified in the Subcommittee's Press Release #16 we support, overall we are very concerned that the approach of the Subcommittee is to repeal an entire body of law which has developed over many years (e.g. eliminating the "substantially related" test, the "convenience" test), and to insert a new test of "inherently commercial", and to propose to tax even related lines of income into nonprofits. Should these proposals to be enacted, many nonprofit organizations would have their operations substantially reduced. At the same time, health care costs would probably rise.

1. We agree with the options for (a) expanding the information reported on Form 990-T, (b) providing more detail of revenue, (c) providing short form reporting, (d) offering affiliated group consolidated return, (e) providing integrated examination program for exempt organizations and subsidiaries, and (f) authorizing various IRS studies, with the exception of studying the effect of changes to UBIT after five years. The IRS is presently increasing UBIT audits and the results of those enforcement actions as well as any studies should precede significant changes to UBIT. Broad scale changes to the nonprofit sector, especially those agencies serving the handicapped and disabled, should not be based on the present and somewhat limited anecdotal information available to the Subcommittee but only after specific studies of their impact have been made.

2. We strongly disagree with the options to (a) repeal the "substantially related" test, the "convenience" test and the "regularly carried on" test. While these formulations are not without some ambiguity, years and years of Revenue Rulings, private letter rulings and court decisions have enabled most nonprofit organizations, their advisors and the IRS to reach a satisfactory level of understanding about their meaning. Clarifying these tests might be advisable but their repeal would only cause confusion among nonprofit organizations.

3. We strongly disagree with the proposal to leave the "substantially related" test in place but to apply UBIT to "all sales or rental income of medical equipment and devices (including hearing aids, portable x-ray units, oxygen tanks, laboratory testing, and pharmaceutical drugs and goods (with exceptions for (1) inpatient, continuous-care outpatients, or emergency treatment outpatients or (2) items not available in immediate

geographic area.)

We are very concerned about the suggestion that, while retaining the test of "substantially related", UBIT would be imposed on activities "whose nature and scope are inherently commercial, rather than charitable." This formulation is troubling for several reasons.

A. Almost every human transaction can be carried on in a commercial, for profit framework. Educating the deaf may be carried on in a for profit institution or in a charitable institution. Providing services to a person with a head injury can be carried on by a religious charity or by a for profit chain. Professional services no less than the provision of equipment or supplies can be categorized as "inherently commercial" depending on the situation of the person doing the categorization.

B. The Press Release assumes that the sale of hearing aids and other devices to persons with impaired hearing is "inherently commercial". However, it might be equally maintained that providing a comprehensive array of speech, language and hearing services to persons who are deaf or hearing impaired is "inherently charitable" or that, in many cases, it is at a minimum "inherently related" to purposes of many tax-exempt organizations.

C. Is the collection of fees for services and devices related to the purposes of the tax-exempt organization "inherently commercial" even though the organization cannot use the proceeds for the inurement of a private individual and even if the proceeds are reinvested in the services to handicapped persons? In short, using a standard of "inherently commercial" would ignore the fundamentals of the nonprofit organization, i.e. that the activity is related to the purposes of the organization, that there is no private inurement with any excess proceeds being used to improve the services for which the organization is tax-exempt.

The implication of this change is that a nonprofit community speech and hearing organization would be in an untenable position. If it provided comprehensive services, as many do, including the dispensing of hearing aids and various other devices, it would have to charge the UBIT to its clients, many of whom have neither health insurance coverage for speech, language and hearing services nor do the ability to pay out of pocket. The nonprofit organization would not have the advantages of a for profit organization in that it would still be bound by the rules of no private inurement. Then, the organization would have to lose either (a) its community reputation for comprehensive services or (b) part of its clientele which cannot afford the extra costs imposed by the UBIT. In either event, the speech, language and hearing impaired citizens would be the losers.

D. The categorization of hearing aids in the Press Release also carries with it an implicit statement that the dispensing of a hearing aid is the same wherever it occurs. That is not necessarily true. Attachment 1 is a survey of hearing aid dispensing conducted annually by Hearing Instruments magazine. It notes some important differences in the dispensing patterns of audiologists and hearing aid dealers.

Generally, audiologists receive more referrals from medical sources than do hearing aid dealers. Far more audiologists than dealers separate the fees for audiological testing clients from that of the hearing aid. This is the case because the testing performed by audiologists is far more extensive than that performed by hearing aid dealers. More audiologists than hearing aid dealers offer money back trial periods. A far greater part of audiologists' income is based on service than is the income of hearing aid dealers. Finally, audiologists provide a wider range of assistive listening devices to their clients with impaired hearing.

Attachment 2 is a recent survey of Ohio hospitals published in The Hearing Journal. While it does not distinguish nonprofit from for profit hospitals, it does support the first survey in that the hospital audiology and hearing aid dispensing programs provide comprehensive services to persons with hearing impairments.

E. Even if the Subcommittee decided to include hearing aids as it has done, it should keep in mind that the current option would cover all nonprofit organizations dispensing hearing aids. Even the National Hearing Aid Society which has strongly supported changes in the UBIT has stated that it "does not contend that every tax-exempt hospital or clinic engaged in the sale of hearing aids does so for other than charitable purposes," even though, in NHAS' eyes "many such organizations have attempted to capture and control the hearing aid market." The NHAS would encourage a less sweeping approach which would apply UBIT to commercial activities "which are more businesslike with regard to marketing and the pursuit of profit, such as organizations which advertise." (Unrelated Business Income Tax, Hearings, p. 797-807).

4. We would like to state some of our concerns about hearing aids which the Subcommittee needs to consider.

A. ASHA is concerned about the Subcommittee's inclusion of hearing aids in this issue. When ASHA testified, we pointed out that, according to the latest information available through the U.S. International Trade Commission, only 4% of all hearing aids were sold by nonprofit agencies. We have not seen any post-hearing comments which dispute the fact that hearing aid sales by non-profits are de minimis.

This is demonstrated in the three attached letters to Congressman Pickle from facilities which were identified as 'unfairly competing' with for-profit businesses. The Alaska Treatment Center reported that it dispensed 285 hearing aids or 23 a month in 1987 with half of them going to Veterans Administration or Medicaid covered clients. The University of Texas at Dallas dispenses 14-16 a month and the Hearing, Speech and Deafness Center in Seattle, Washington dispenses approximately 33 aids per month. They state that about 50% of their clients would not be able to afford the current local customary prices. By comparison, the 1987 survey results in Attachment 1 would indicate that sales of hearing aids are growing and that most hearing aids dispensed by audiologists in clinics (some of which are nonprofit) are in the low end of the monthly volume spectrum. As a matter of fact the largest percentage of dispensing audiologists in clinics dispense only 5 to 10 hearing aids a month. The survey in Attachment 2 would also indicate that 75% of the hospital audiology programs in Ohio dispense fewer than 10 hearing aids a month.

B. The scope of the proposed change.

While the Subcommittee has heard complaints from hearing aid dealers about competition in the sale of hearing aids and while the hearing aid dealers appear concerned about the devices traditionally considered to be the behind-the-ear or in-the-ear hearing aid, there is a much larger category of devices to assist the communicatively impaired including implantable hearing aids, cochlear implants, FM devices, assistive listening systems, tinnitus maskers and augmentative communication devices for persons who cannot speak which will be taxed under the "medical equipment and devices" category, even though the dispensing of these items does not compete with for-profit businesses.

The effect of these changes on university clinics which provide training for students in speech-language pathology and audiology is also a major concern. Often, these clinics have a high overhead costs because of the space and equipment needed and a small number of students.

C. Definitions.

"Immediate geographic area" has to be defined. We are very concerned that this definition be narrow enough to take into account that many private hearing aid businesses are not likely to choose to locate in either remote geographic areas or in parts of urban centers with a concentration of persons with low incomes. For example, in the Washington D.C. metropolitan area, a dispenser of hearing aids would probably choose a business location in Montgomery County, Maryland or Fairfax County, Virginia. The areas of NE Washington or Anacostia should not be considered within the same geographic area.

We are also concerned that this might place the application of the UBI tax in the hands of an individual business, leaving the nonprofit organization's planning for its revenue at the whim of any change in the "immediate geographic area" if a for profit enterprise should enter that area.

In other words, an inner city hospital may be the only source of assistance to local persons with impaired hearing. If a for-profit dispenser of hearing aids decides to open a one-day a week satellite office in the "immediate geographic area", will that change the status of the hearing aid dispensing from a non-taxable event to a taxable one? How could the inner city hospital attract staff to provide services in such an unpredictable manner? Would the proposal grandfather in all nonprofit settings in the immediate geographic area or would that be computed annually? As one can readily see, this standard appears to provide no clarification at all.

"Continuous Care Outpatient" must also be defined. Does this mean a patient who receives long term outpatient care? If so, how will that be quantified? Will a patient have to receive a certain number of services within a year or quarter or month in order to be considered a "continuous care outpatient"? Will a patient who receives only hearing related services, such as a hearing impaired child, be considered "continuous care" or do other services have to be provided?

D. The effect on costs

The survey mentioned above indicated that the average cost of the hearing aid sold was $531, a $10 increase over the 1986 survey figure. Ms. Robin Holm testifying for the National Hearing Aid Society noted that while she spends $200 (p.831) to acquire a hearing aid from a manufacturer, she charges the consumer $895. Northwest Hospital who is allegedly unfairly competing with her, charges $595 (p.829).

Likewise, another survey (Attachment 2) of Ohio hospitals indicates that very few charge over $600 for a hearing aid while a majority of their competitors sell hearing aids at a far higher price. This survey did not separate out for-profit from nonprofit organizations.

For years, Congress and especially the Committee on Ways and Means has complained of the inflationary increases in health care costs. The Committee has proposed and the Congress has enacted a great deal of legislation to control the increase in hospital and physician health care costs. It is ironic, to say the least, to see the Committee now assume a posture that nonprofit hospitals and clinics dispensing hearing aids in a competitive manner, providing more services from better trained professionals to the poor and handicapped are 'unfairly competing' with other dispensers because they do not mark up the price on the hearing aid at the level of the highest markup in the community. Would the Committee propose that physicians should all charge the highest fee charged in their community for a service? Hardly! Why then should it target community supported nonprofit agencies because they charge less for more service than their competitors?

E. The real case of "unfair competition".

The letters published by the Committee had an additional touch of irony which would be almost humorous except for the fact that the Committee appears to take these claims seriously.

Almost all of the letters sent to the Committee from hearing aid dealers complaining of 'unfair competition' by nonprofit agencies are from hearing aid dealers using the title handed out by the National Hearing Aid Society, "Certified Hearing Aid Audiologist" (see p. 1931, 1943, 1955, 1956,1966, 2164, 2177, 2221,2328). The term "Certified Hearing Aid Audiologist" is a real case of "unfair competition". It has been used, and continues to be used by NHAS and by hearing aid dealers who, in many cases only have a high school education, to imply to the public that these dealers have received a master's degree education as an audiologist when they have not.

Some 31 states have banned the use of that title. (See Attachment 3). As a matter of fact, four hearing aid dealers who wrote the Committee appear to be flouting state law because the term is prohibited in those states (Montana, Ohio, Massachusetts and Michigan).

This title, "Certified Hearing Aid Audiologist", was a federally registered mark of the National Hearing Aid Society until October 1984 at which time the U.S. Trademark Trial and Appeal Board decided in what they considered to the be the longest and most voluminous case in their memory, that the title, "Certified Hearing Aid Audiologist" was misleading and deceptive to consumers. (See Attachment 4). They then canceled the federal registration of the mark.

In other words, those complaining most about 'unfair competition' from qualified audiologists in nonprofit settings are the organization (NHAS) and its members (who call themselves Certified Hearing Aid Audiologists) who have misled, and are continuing to mislead, consumers with impaired hearing by their use of a false title.

5. Implications for 501(c)(6) organizations.

ASHA is a professional organization exempt from taxation under section 501(c)(6). ASHA's ability to finance the scientific, educational, and consumer activities for which we are organized is limited. Due to the 1987 Tax Reform Act, the deductibility of membership dues, especially for our members whose average income is in the mid-twenty thousand dollar range, is already quite limited.

Because this year's tax filings will be the first time many individuals will actually see the decrease in the deductibility of their professional dues, we believe it would be highly inappropriate to make other changes in the taxation of association sources of non-dues income. This would apply to the consideration of application of UBIT to (a) affinity credit cards, (b) royalty income, (c) advertising income, (d) travel and tour services, (e) distribution of articles, including low cost articles, (f) rental of membership lists and (g) trade shows. Recognition of indirect costs in the allocation rules is an important concept to retain. Indirect costs are recognized in both the for profit and the nonprofit sectors as a cost properly included in the total costs of an organization. They are fundamental costs which any interpretation of sound accounting practices must take into account.

In conclusion, the options being considered by the Subcommittee would apply the UBIT to almost every source of income available to tax-exempt organizations, except for direct grants. The implications of any one of these changes for nonprofit organizations serving or representing the interests and aspirations of persons with handicapping conditions is significant and substantial. ASHA urges the Subcommittee to carefully consider the implications of each such option.

Sincerely,

Morgan Downey, Esq.
Director
Governmental Affairs Department

[Attachments to this statement are being retained in the Committee files.]

STATEMENT TO
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS

FROM

FRANK FINKEL, CHAIRMAN
GOVERNMENT AFFAIRS COUNCIL
AMERICAN SUPPLY ASSOCIATION

On behalf of the American Supply Association (ASA), I am pleased to submit these comments relating to the Subcommittee's discussion options on changes to the Unrelated Business Income Tax (UBIT). ASA represents nearly 1200 companies distributing plumbing-heating-cooling equipment throughout the country. Formed in 1893, and with a current annual budget of $2.5 million, ASA and its predecessor has served as our industry's voice, striving to provide the leadership and direction necessary to unify and strengthen our industry as a whole.

ASA has closely followed the Oversight Subcommittee's investigation of UBIT-related issues over the past year. In light of the tremendous growth of non-profit and tax-exempt organizations since the inception of the UBIT statute in 1950, the Subcommittee's work in this area is especially appropriate. And, Mr. Chairman, we would like to take this opportunity to say we believe the Subcommittee has done a credible job in pulling together the many threads of this complex subject.

After listening to the extensive testimony presented during Subcommittee hearings last June, we fully appreciate the seriousness of the unfair competition issues which have been raised and we understand the important federal budgetary concerns which have also driven the Subcommittee's investigation.

With this in mind, we find many of the options identified by the Subcommittee to be positive steps toward improving the UBIT system. In particular, the more detailed reporting requirements would enhance IRS' ability to ferret out abuse of the UBIT law. The modifications relating to taxable subsidiaries and joint ventures also make sense and would help to assure that the UBIT law is not circumvented by the clever use of affiliated entities.

One point, however, where we are in disagreement is with regard to changes in the "substantially related" test. ASA's overall position on UBIT rests on the firm conviction that the basic framework of the statute is essentially sound. Its underlying policy considerations on the role of tax-exempt and non-profit organizations remain valid today. And the heart of the law -- the "substantially related" test -- is still a useful and appropriate standard for determining what income of tax-exempt/non-profit organizations is to be taxed. In fact, the Treasury Department also maintains that the "substantially related" test still has conceptual merit and, in their testimony to the Subcommittee last June, Treasury recommended retention of this standard in the UBIT law.

The problems associated with UBIT and the substantially related test over the past decade, we believe, lie not in the substance of the Act, but in its administration and enforcement. Expanded reporting requirements, coupled with a renewed commitment by IRS to enforce UBIT, would significantly increase compliance and alleviate abuses. More detailed reporting would also enable the IRS to better identify funding trends and trouble spots which may warrant additional changes in the statute.
At this point, however, far more precise information is required as to the nature and extent of the problem before tampering with the "guts" of the UBIT Act. Both the General Accounting Office and the IRS have reached similar conclusions. In view of the complexity of UBIT, its application to such a broad spectrum of organizations and the lack of available data, Congress must take great care not to "throw the good out with the bad". The very real concerns of small business competitors must be cautiously balanced against the long-recognized and valuable benefits to our society derived from tax-exempt and non-profit organizations. Accordingly, we do not agree with the Subcommittee's alternatives for eliminating or modifying the "substantially related" test.

On another issue of particular concern to ASA: we noticed the Subcommittee's indication that it will also "consider modifications of various piecemeal UBIT exclusions enacted since 1969." One of those exemptions -- the trade show exemption -- merits special comment.

For not-for-profit associations like ASA, income from trade shows is, quite simply, necessary to our existence. Our need for supplemental revenues is underscored by the fact that only 12% of our budget is covered by membership dues.

The fact is that we do not have a broad membership base. At the same time, the regular activities of ASA are not, standing alone, financially self-sustaining. As an industry association, we are primarily involved in educational programs for our members, public information projects, safety and industry standard programs -- all of which involve a significant cost to our organization with little return on the dollar. We rely on revenues raised from trade shows to balance our budget as a not-for-profit. Taxation of these revenues, which are derived from activities substantially related to our exempt purpose and used to support our tax exempt activities, would drastically limit our ability to function as an effective trade association for our members.

It is also important to note that the trade show exemption does not sanction commercial activity in competition with the private sector. For industry associations like our own, quite the opposite is true. It enables us to do our job as a tax-exempt trade association. And the trade show is a fundamental element of association activity. At ASA, the p-h-c-p trade show runs concurrently with our annual convention, with the entire event viewed as the highpoint of our activities for the year. At the convention, we bring together the members of our association for educational and informational sessions, election of the association officers, and a sharing of ideas and experiences. Workshops are conducted, informing members how to comply with HazCom standards, for example, or how to employ the latest marketing techniques.

At the same time, the trade show offers manufacturers the opportunity to display the latest products of the plumbing-heating-cooling industry. This is totally an industry function -- not a commercial activity. The revenues from the trade show which are derived from renting booth space to suppliers, are an integral part of our role as a trade association. Congress recognized this in 1976 when the specific exemption for trade show revenues was enacted. This exemption became necessary after conflicting IRS rulings resulted in confusion on the tax treatment of trade show income. The trade show exemption is a valuable provision in UBIT. It encourages the work of trade associations (and for smaller and medium-sized associations, assures their survival), promoting a vigorous and healthy business environment. We, therefore, urge the Subcommittee to leave the trade show exemption in its present form.

For many of these same reasons, ASA also continues to oppose any proposal to tax the net investment income of trade associations. Again, we depend on these kind of non-commercial revenues to offset the costs of carrying on our regular trade association activities. A tax on these revenues would curtail many essential and beneficial trade association programs. At the same time, a tax on our association's net investment income would not be without some negative impact to the government. ASA currently invests its money on a "no-risk" basis. That is, our money is placed to a large extent in various low-interest bearing federal instruments in order to minimize risk to our members' association funds. We do so as a policy matter, but can afford to do this because our investment income is tax-exempt under UBIT. However, if UBIT is changed to encompass investment interest, ASA would have no choice but to invest instead in higher yield instruments. Through the cumulative responses of similarly situated trade associations, the federal government would, therefore, be depriving itself of a ready source of funds.

Mr. Chairman, we appreciate the opportunity to comment on the Subcommittee's UBIT options. We recognize the demanding task that you, the Subcommittee members and staff have before you. ASA asks only that the Subcommittee approach this final stage of its investigation with the prudence and diligence required by the risks involved to our members. Thank you for your consideration of ASA's views.

STATEMENT BY THE AMERICAN SYMPHONY ORCHESTRA LEAGUE TO THE HOUSE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE CONCERNING DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

Submitted by Catherine French, Chief Executive Officer of the American Symphony Orchestra League, on April 15, 1988

The American Symphony Orchestra League, founded in 1942 and chartered by Congress in 1962, is the national nonprofit service organization of symphony orchestras and symphony orchestra personnel--conductors, managers, musicians, trustees, and volunteers. The purpose of the League is to ensure the artistic excellence and administrative effectiveness of America's orchestras.

The League has had an opportunity to examine the options relating to the Unrelated Business Income Tax (UBIT) put out by the Subcommittee in its press release #16 on March 31, 1988, and we welcome the opportunity to express our views on the potential impact these options would have on the orchestra field if enacted.

The League believes that many of the proposed options, if enacted, could have a devastating effect on the financial stability of symphony orchestras in the United States, and we urge that they be dropped from consideration by the subcommittee. In addition, other options are not entirely clear and raise serious questions as to their impact on orchestras. We shall address these concerns as they apply to each specific option.

The concerns to the League and its member orchestras are:

1. Application of UBIT to gift shop/bookstore income (with exceptions for on-premise sales of low-cost mementos and on-premise sales of an educational nature which relate to the organization visited). What is the definition of low-cost? A $4 keychain with an orchestra's logo would presumably be exempt from UBIT, but what about a bust of Beethoven costing $50? Recordings by the orchestra being visited would presumably come under the "educational nature" category, but what about a recording by another orchestra of the same work? Would all books about music be considered of an educational nature and therefore be exempt from UBIT as well?

2. Application of UBIT to income from all catalog and mail/phone order or other "off-premise" sales. Although it is unlikely that the subcommittee intends to cover mail order sales of tickets to concerts, a literal interpretation of this option could mean just that. What does the subcommittee intend? In addition, radiothons, which have become such an important fundraising tool for orchestras, would presumably come under this provision and would offset many of the gains that orchestras realize from this fundraising method.

3. Application of UBIT to adjunct food sales (with exception for on-premise services and/or sales provided primarily for students, faculty, employees, member or organization visitors). Although restaurants and cafeterias on the premises of an orchestra would presumably be exempt from UBIT, would distinctions be made for food sales to the general public when a performance was not taking place? How would those distinctions be made?

4. *Application of UBIT to advertising income and allowing deductions from UBIT only for direct advertising costs.* Repealing the rule that costs of the editorial content of a publication (such as the League's official publication, *Symphony Magazine*) can be offset by advertising income would have a significant negative impact as advertising income is used to defray the cost of an organization's programs as reflected in its publications. In addition, concert programs, which are used to educate an audience about a performance and which are not supported by ticket costs, rely on advertising as the only means of support for the publication. These publications are educational in nature, serve that exempt purpose of the organization, and rely on advertising income to offset the total costs of the publications. We hope that language can be drafted so that advertising in concert programs and in publications such as *Symphony Magazine* could still be allocated against the total cost of the publications since there is no other way to pay for them.

5. *Repeal of the "convenience" exception (income from activities carried on primarily for the convenience of a Section 501(c)(3) organization's members, students, patients, officers, or employees).* Although the subcommittee apparently continues the exemption from UBIT for food sales, would the exemptions on income from parking lots and coat room services be continued as well?

6. *Repeal of the "regularly carried on" test.* A number of fundraising activities (such as charity balls and benefit concerts) are now sheltered by the "regularly carried on" test. Although there is reason to believe that once-a-year galas would be exempt from UBIT, is this indeed the subcommittee's intent?

7. *Application of UBIT to royalties measured by net or taxable income derived from the property; or royalties received by an organization for use of property if such organization either created such property or performed substantial services or incurred substantial costs with respect to the development of such property.* Recording classical music is clearly related to the purpose for which orchestras are formed and serve an educational purpose as well. Therefore, would orchestras that license commercial music companies to sell recordings of their performances be taxed on the income from that effort? Would the royalties that orchestras earn on their own recordings be taxed?

8. *Modification of various UBIT exclusions, including exchanges and rental of membership or donor lists among tax-exempt organizations.* The exchange and rental of mailing lists among arts organizations is a legitimate way of doing business and should be exempt from UBIT. Mailing lists of other arts organizations are valuable tools for orchestras to increase their audiences and educate the public about their programs.

AMERICAN VETERINARY MEDICAL ASSOCIATION
GOVERNMENTAL RELATIONS DIVISION · SUITE 828
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April 14, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

On behalf of the more than 46,000 veterinarians who belong to the American Veterinary Medical Association (AVMA), I am pleased to offer the following comments on the discussion options relating to the unrelated business income tax (UBIT). First and foremost, AVMA applauds Chairman Pickle, Mr. Schulze and other members of the Oversight subcommittee for their efforts. Unfair competition from tax-exempt organizations remains an important problem for private clinical veterinary practitioners and AVMA appreciates the subcommittee's recognition of this issue. Implementation of some of the options contained in the draft will be an important first step toward fair competition.

AVMA specifically would like to address the discussion option that examines the "substantially related" test as it applies to veterinary services. Simply put, the option as drafted is woefully inadequate and in many ways more unfair than the present situation. Instead, AVMA respectfully offers the following revision of that section:

I. F. Apply UBIT to income from all veterinary services, with the exception of veterinary services performed on stray animals or animals owned by indigent people; veterinary services performed by teaching institutions in order to provide clinical education for veterinary medical students and technicians; and spaying and neutering, where there are indications that the private sector is unable to provide this service.

The option as originally proposed by the subcommittee permits tax-exempt organizations to provide a full range of veterinary medical services to the general public without paying any unrelated business income tax. More than 90 percent of the services offered by a private veterinarian in companion animal veterinary medical practice fall under the general headings of "measures to protect the public health" and "measures recommended by a veterinarian for the health of the animal." Instead, the definition should be structured so that tax-exempt organizations would be required to pay UBIT on all income from veterinary services, with exceptions for veterinary services that are truly consistent with legitimate charitable purposes.

The discussion option offers no qualifications regarding the nature of the surgical or medical treatment, the financial status of the animal's owner or whether or not those services represent routine medical care. AVMA recommends that the committee structure an exemption from UBIT for those services that are performed on the organization's own animals, stray animals and animals owned by indigent people. This recognizes the class of animals that fall within the legitimate purview of a tax-exempt organization. Spay and neuter clinics in situations where the private sector is unable to provide this service would also fall into this category.

Finally, because institutions that educate veterinarians need to provide their students with opportunities for clinical education, AVMA also recommends that there be an exemption from UBIT for educational institutions that offer veterinary services to provide clinical education opportunities for veterinary medical students.

The discussion proposal also classifies grooming and boarding under the same umbrella as veterinary medicine. These services are ancillary to, rather than part of veterinary medicine and all references to these services should be removed from the proposal.

AVMA proposes the alternate rewording detailed above as a fair and equitable first step toward fair competition, one which does not compromise the legitimate charitable function of a tax-exempt organization in any way. Nonetheless, AVMA recognizes that UBIT is insufficient to solve the problem of unfair competition. Directly competing businesses must be required to operate under the same tax laws. Exempt status could still be retained for those hospitals that limit their services to stray animals or those animals owned by people unable to pay for veterinary services and those that offer only spaying and neutering procedures.

I have enclosed supplemental information that should broaden your perspective on the competition issue in the veterinary services area. Each example is described briefly in the following paragraphs.

The $1 Million Humane Society Hospital: The January 1988 issue of *Veterinary Economics* features the "$1 Million Humane Society Hospital" which was built at a cost of $167 per square foot, a cost almost three times the national average. These figures do not include any costs for site, equipment or furnishings. The hospital described itself on its contest entry form as "a full-service hospital which also functions as a low-cost sterilization clinic and a charitable animal hospital." According to a veterinarian employed by the Michigan Humane Society, the facility sees 30-60 clients per day and performs 10 additional spay and neuter procedures daily. Nonetheless, the director of the Michigan Humane Society consistently contends that the work of this hospital is totally within the scope of the humane society's charitable mission.

Macomb Humane Society: According to a press clipping from the *Detroit News*, the balance of this hospital's trade is "middle class people who also find regular vet fees prohibitive and will drive a few miles to save a few bucks." The humane society charges between 30 and 50 percent less than a private clinic, according to the article.

Information on Selected Spay-Neuter Clinics and Programs: This information, published by the Humane Society of the United States, surveys spay-neuter clinics across the country. Many are open to any animal without restriction. Most show a dramatic decrease in the number of animals they are spaying and neutering.

Examples of Unfair Competition Across the Country: Individual veterinarians across the country alerted AVMA to examples of unfair competition in their areas. Reports from Florida, Ohio, Virginia, Texas, Utah and New Jersey chronicle individual cases of unfair competition. A survey conducted by the California Veterinary Medical Association is also attached. According to the survey, 17 out of 26 local veterinary medical associations reported that they face competition from nonprofit providers of veterinary services.

Comments and Policies Regarding Unfair Competition: Statements by the Pennsylvania and Michigan Veterinary Medical Associations voice loud concern about competition with tax-exempt organizations. An article which appeared in *Veterinary Practice Management* chronicles some recent cases.

AVMA Clearinghouse on Government-Subsidized Veterinary Services: AVMA maintains extensive files on the issue of government-subsidized veterinary services, where nonprofit organizations as well as the public sector are competing with private veterinary clinical practices. We will be happy to provide you with any of the materials listed in this index.

In conclusion, the threat of unfair competition for private veterinary medical practitioners is real. Although reform in the UBIT is a partial solution, AVMA does not believe that this will address the full scope of the problem. Private veterinary practitioners strive to meet the demands of the public for high quality services while veterinary medicine constantly evolves to maintain its status as a modern health profession. The overhead costs associated with a highly technological practice that is based in a small business environment are formidable enough without introducing unfair competition into the equation.

AVMA sincerely appreciates the thoughtful approach taken by the subcommittee on this issue and hopes that steps such as the proposals outlined in the draft discussion options and in these comments are taken to rectify this serious problem. AVMA will be happy to provide any additional information that may be useful. Thank you once again for the opportunity to comment.

Sincerely,

Marcia D. Brody

Marcia D. Brody
Governmental Relations Division

enclosures

[Enclosures submitted are being retained in the Committee files.]

AMES HEARING AID CENTER

P.O. Box [illegible], 118 East 13th Street, Ames, Iowa 50010

JUDY & JERRY D. SMITH, Owners
Certified by the
National Hearing Aid
Society

Board Certified

April 14, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Unfair Competition

Dear Chief Counsel Leonard:

Thank you for your interest in our plight concerning unfair competition in the hearing aid dispensing field.

In Central Iowa the retail hearing aid dispensing industry is threatened by the dispensing of hearing aids by non-profit Easter Seal programs, hearing and speech centers, and assorted other tax exempt organizations. Unfortunately people go there thinking the hearing aids are sold at discounted prices, many times they are not. After the professional fees are added to the price of the hearing aid, the price is equal if not more than that of the retailer. After the people return home with their new hearing aid, they still do not have local service. Many times transportation to this clientele is a very serious problem resulting in the hearing aid falling into disuse because of the lack of follow-up service.

Post fitting, service, cleaning, and etcetera, should be available to the patient every three to four months. At most retailers this service is usually provided free of charge for the lifetime of the hearing aid. To compare the total cost, tax paying retail verses tax exempt non-profits, the cost is usually more from the non-profits and still do not have the benefit of local service.

It is very hard to compete with these groups as they enjoy television, newspaper, and radio advertising free of charge as community service. These people also enjoy large facilities, contributions from groups such as United Way, tax exempt statis, and referrals from other professionals not fully aware of their pricing structure.

I can expect this type of enterprise wherever the service is not already provided from the private sector but we have non-profits springing up well within the community of the retailers with employees of equal education and statis.

I have to pay my rent, advertising, office expenses, janitor, telephone, payroll of eleven employees(four clinical audiologists), taxes, and hopefully show a profit in the face of non-profits. Small businesses have a heavy burden to carry and this type of government endorsed operation is "unfair competition."

I urge you to apply Unrelated Business Income Tax to all hearing aid sales income of non-profits because of the inherent commercial nature of the sales. I urge you to repeal the existing "convenience" exemption for patients as inpatients only.

Sincerely,

Jerry D. Smith

Jerry D. Smith

JDS/ph

Arrowhead Hearing Aid Center

Free Testing - Fitting All Ages - Service

RADIOEAR since 1922
DAHLBERG, TELEX
and most leading brands

2105 East SUPERIOR Street
DULUTH, MINNESOTA 55812
218/728-3787

April 12, 1988

Honorable J. J. Pickle, Chairman
House Ways and Means Oversight Subcommittee
U. S. House Of Representatives
Washington, D. C. 205154

Dear Representative Pickle: RE: UBIT)

On behalf of the Minnesota Hearing Aid Specialist (speaking as a past president) many thanks for your efforts regarding reform of the Unrelated Business Income Tax system that applies to non-profit organisations.

It is a wonderful feeling when we help someone with amplification to hear better and see the face light up; however, we are struggling harder now that the doctors send our referrals down their halls to be fitted, and the University Minnesota Duluth, like other schools, are also selling hearing aids in their audiology departments and in public schools.

We really appreciate your efforts against this unfair competition from nonprofits. If small businesses are to survive, these practices must be stopped. We are blessed to have someone in Congress who cares for us.

God bless you and your committee.

Sincerely,

Louise Olsen

Louise Olsen
Board Certified-HIS

1300 College Drive • Waco, Texas 76706 • 817/752-4371

TheArtCenter

April 8, 1988

The Honorable J. J. Pickle
Democrat, State of Texas
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

Dear Representative Pickle:

I am concerned over several discussion options which the Committee will meet upon after April 15th; in particular, I. Substantially Related Standards - A. Gift Shops and Bookstores (On-Premise Sales and Off-Premise Sales), D. Travel and Tour Services, II. Convenience Exception, and IV. Royalty Exclusion.

Museums across the country have been heavily hit by the new tax laws so that we have seen a marked reduction in gifts from established contributors. This has hurt museums in the Northeast (since I just came from a museum in Massachusetts) and Texas (where I am now the Director). Coupled with the patrons tax concerns, which have hurt raising funds for the arts, is the Texas economy which sees its darkest days in its glorious history.

There has to be some place where 501(c)(3), non-profit museums and other organizations can make up what has been lost by tax reform and the declining economic picture. If you do not want to see Texas museums going through the same trauma that the Texas banking establishment has been put through, I would most strongly suggest that these laws are not changed at this time.

There may be a logic to change at some time five to ten years down the road when the creative minds of museum directors can find a way to stay afloat but now is not that time.

I urge you and the committee to leave these provisions in the law alone.

Discuss them all you wish but please support me and my membership of this museum in keeping these ways to earn a living so that the cultural life of Central Texas stays vibrant and helps the economic recovery that we all know Texas will feel some day.

Thank you for your time and consideration.

Sincerely,

Joseph L. Kagle, Jr.
Director

JK/jdb

ASPENWOOD ANIMAL HOSPITAL
1290 SOUTH COLORADO BOULEVARD
DENVER, COLORADO 80222
(303) 757-5646

DUANE T. ALBRECHT, D.V.M.
JOHN F. HUFF, D.V.M.

Members
American Veterinary Medical Association
American Animal Hospital Association
Colorado Veterinary Medical Association
Denver Area Veterinary Medical Association

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Represenatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to express deep concern about the unfair competition which veterinarians face from tax-exempt business organizations (e.g. humane societies). We, as veterinarians, have devoted years of our lives training for and then providing quality veterinary medical services to our communities. Currently, factors such as the oversupply of veterinarians, regionally depressed economies, consumers' financial limitations, and the lack of pet health insurance cause our fees to be held to very reasonable levels and make it extremely difficult for new graduate veterinarians to establish private practices.

We now find our livelihoods seriously threatened on an additional front. We now face competition from tax-exempt organizations which provide veterinary services to the general public for fees far below that which we in private business must obtain to survive, let alone achieve even modest profits. We fully support the primary mission of these organizations which is to provide humane care for homeless or abused animals. We do, however, feel that serious inequities develop when such organizations are allowed to provide veterinary services which are in direct competition with existing private business.

The first major inequity in the competition between private and tax-exempt businesses is the comparative costs of doing business. The tax-exempt organizations are able to build and equip their facilities with dollars from tax-exempt contributions instead of the high-interest loans available to the private sector. These organizations have reduced operational costs because of numerous tax exemptions (property tax, postal rates, etc.) and volunteer labor.

Secondly, they have east access to low-cost or free publicity and advertising through media exposure. This leads consumers to believe that they fulfill a moral obligation to help care for the animal kingdom when they patronize these organizations. The tax exempt groups can appeal for financial support and inadvertently discredit private business on the grounds of "profit making".

Finally, the humane organizations, as major suppliers of new pets to most communities, often suggest or require the new pet owner to return to their facilities for initial veterinary services (vaccinations and sterilization procedures), thereby capturing an important source of new clients and income from surrounding veterinarians.

In conclusion, fair competition between private and tax-exempt organizations is impossible because of severe economic, promotional, and consumer-related inequities. These unfair business practices conflict with the basic free-market economic principles of our society. We believe that the function of tax-exempt organizations should be to provide humane care for animals which are homeless or abused and to furnish complete medical services only to those animals that belong to indigent people. And we believe that, if allowed to provide complete veterinary service, these organizations should forfeit their tax-exempt privileges and compete fairly with private businesses.

Sincerely,

Duane T. Albrecht, D.V.M.
President American Veterinary
Medical Association 1983-1984

ASSOCIATION OF AMERICAN MEDICAL COLLEGES

Many of the core activities in which AAMC-member institutions are engaged (research, education, patient care, technology development) have come under close scrutiny during the Subcommittee's recent review of the UBIT laws. We accept this examination as a proper Congressional function. However, we feel strongly that any changes in the UBIT rules must be based on documented fact, not subjective perceptions of abuse or anecdotal evidence.

Before making comments on the specific options listed in the Subcommittee's press release, the Association would like to commend the Subcommittee for leaving unaltered the UBIT research exception. Having worked closely with other members of the higher education community, the AAMC is aware of the large volume of evidence that was presented on the necessity of retaining the research exception. We are pleased that this evidence has apparently persuaded the Subcommittee to continue the research exception in its present form.

At the same time the AAMC notes the vague nature of many of the options presented by the Subcommittee. As will be noted below, many of the changes in the UBIT laws proposed by the Subcommittee are quite substantial. A great many of these changes hinge on interpretations that would have to be based on subjective decision-making, since no definitions for many new terms or standards are provided. We feel this will lead to a situation where affected institutions will have difficulty complying with the statute, and the IRS have difficulty in enforcement.

The "Substantially Related" Standard

The Subcommittee's option paper proposes either retention of the substantially related test, but imposing UBIT on any activity whose nature is inherently commercial, rather then charitable, or repealing the test and replacing it with either a new "directly related" test or mandating that individual activities on their own must qualify as exempt.

The AAMC opposes changing the present "substantially related" standard, and makes the following specific observations:

- "Directly Related" Test Current law requires there to be a strong or casual relationship between an activity and the exempt purpose of an institution in order for it to be deemed "related". Further, the activity must "contribute importantly" to the accomplishment of the exempt purpose. The AAMC believes it is noteworthy that in its UBIT testimony on June 22, 1987, the

Treasury Department concluded that the "substantially related" test "is a good one, [and] that it is difficult to improve upon..." We urge the Subcommittee to adhere to Treasury's recommendation that the present standard be retained and effort focused on "obtaining more detailed information concerning the revenues of exempt organizations and the basis for treating them as tax-exempt".

The options paper gives no indication of how the "directly related" test would differ in application from the present standard. Moreover, we find it counterproductive to abandon the "substantially related" test when a significant body of knowledge and opinion on it and its applications is in existence.

o Qualify Singular Activities As Tax-Exempt The Subcommittee option paper also suggests requiring each income-producing activity of an exempt organization to, on its own, qualify as tax-exempt. The AAMC believes that a determination of whether an activity in and of itself is tax-exempt -- and out of context of the organization's overall charitable mission -- is highly artificial and arbitrary. While present law, through the fragmentation rule, allows for an examination of activities on an individual basis, the determination is made on the basis of whether the activity in question contributes importantly to the institution's exempt mission -- not the generic tax-exempt nature of the activity itself. The Association feels that the adoption of the standard presented by the Subcommittee would create great confusion (both for affected institutions and the IRS) and, further, would be contrary to the purpose of the UBIT laws.

o Commerciality Standard A third option detailed in the press release for change in the "substantially related" test is preserving the overall test, but imposing the UBIT on specified activities whose "nature and scope are inherently commercial." Before commenting on the specific activities listed as taxable, the AAMC wishes to point out that it strongly disagrees with the use of a "commerciality" standard -- particularly since no reasoning is given for its adoption, or of its relationship to the advancement of the purpose of the UBIT laws.

Moreover, we are concerned that the specific areas identified for taxation are the same areas identified as troublesome by representatives of the small business community during the UBIT hearings last summer. In our opinion, this situation could lead to the conclusion that a list such as that detailed in the press release springs more from the vociferousness of a particular group's political agenda, rather than from sound tax policy. We reject this approach as undesirable and unwarranted, as it is based merely on anecdotes and not facts and data.

1) Apply UBIT to all sale or rental income from medical equipment and devices, laboratory testing and pharmaceutical drugs and goods. Exceptions would be made for inpatients, continuous care outpatients, and emergency treatment outpatients, or for items not readily available in the immediate geographic area.

In this portion of the options paper, the Subcommittee has developed an arbitrary classification for the spectrum of individuals served by hospitals. Specifically, the lack of a definition of a "continuous care outpatient" -- both here and, as it relates to the use of the term "patient" or care provided by hospitals, in other sections of the options paper -- makes evaluation of this proposal difficult if not impossible. Further, the criteria in this section runs afoul of existing rulings on the definition and treatment of the term "patient" with regard to the imposition of the UBIT.

Specifically, we urge that the Subcommittee refer to Revenue Ruling 68-376, dealing with sales of pharmaceutical supplies by a hospital to "patients." The ruling said that sales to the following types of individuals are sales to "patients" and do not generate unrelated business income:

-- those admitted to the hospital as an inpatient;

-- those receiving therapeutic or preventive health care services from outpatient facilities at the hospital;

-- those directly referred to a hospital's outpatient facilities by a private physician for specific procedures;

-- those refilling a prescription written during the course of treatment at the hospital;

-- those receiving medical services as part of a hospital administered home care program; and,

-- those receiving medical care and related services in a hospital-affiliated extended care facility.

With regard to the sales of medical equipment and devices, we urge the Subcommittee to examine Revenue Ruling 78-435, which held that the sale of medical appliances is an integral part of a hospital's treatment of its patients (as defined in Revenue Ruling 68-376). We believe this definition of patient should also be used in evaluating laboratory testing performed by a hospital (more detailed comments on testing are below).

2) Apply UBIT to routine testing income, with exceptions for Federal or state mandated activities, presurgical medical testing, and laboratory testing which is part of a student educational training program.

Present law provides that income from testing of a routine commercial nature is generally not exempt from UBIT. We understand that lack of a clear definition of what constitutes testing makes application of this standard difficult. However, to tacitly define what is related testing activity (as the Subcommittee has done by identifying three testing areas that will not be subject to UBIT) ignores the relationship of many other types of testing to the exempt missions of many institutions, particularly so in the case of academic health centers.

Specifically, many academic medical centers and hospitals perform diagnostic pathology tests on samples submitted by physicians associated with the institution. The U.S. Tax Court, in St. Lukes Hospital of Kansas City vs. U.S., has held that the performance of these type of tests is directly related to the hospital's tax-exempt function. Additionally, there are numerous routine tests performed on patients who are referred to the hospital by a private physician because the hospital is uniquely qualified to perform such services. Many of the diagnostic and treatment activities related to obstetrical care fall into this category.

We are also concerned that the Subcommittee has ignored the link between certain types of testing or data collection and basic research. Many of the research activities conducted at U.S. medical schools and academic hospitals depend on data from standardized or routinized testing in order to prove or discount the hypothesis of the researcher (as is detailed in the research protocol). This is especially true for experimentation leading to the development of new therapeutic agents, by way of the use of clinical trials. We urge the Subcommittee to be sensitive to the need for critical testing activities to continue to be viewed as part of the overall basic research effort.

> In light of these facts, the AAMC believes that the most sensible and fair approach to this issue is to allow testing activities to be judged against the present "substantially related" test. This would allow those testing activities that contribute importantly to the exempt mission of the organization to continue to be non-UBIT generating.

In sum, the Association believes that retention of the present "substantially related" test is the best method for accomplishing the goals that were defined when the UBIT laws were originally enacted. It allows tax-exempt organizations to pursue their missions, while demarcating those activities not consistent with such missions. We support moves that would require more detailed reporting by exempt organizations as a way to identify true areas of concern. To again quote from the testimony of the Treasury Department before your Subcommittee "we believe the [substantially related] standard, as interpreted by the regulations has conceptual merit." Further, "... additional detailed reporting could provide the basis for better enforcement and compliance ..." We urge that Treasury's recommendations be followed in this area.

The "Convenience" Exception

The Subcommittee has proposed to repeal the exception from the UBIT for those activities carried on for the convenience of members, patients, students, officers or employees. According to the press release, those activities that are nevertheless substantially related to the organization's exempt purpose would continue to be untaxed, subject to a delineated set of exceptions to the "substantially related" test (including those detailed above).

Our first concern with this option is one of scope. Is the Subcommittee proposing to eliminate the "convenience exception" only if the third option for modifying the "substantially related" test is adopted? Would the "convenience exception" be repealed if a "directly related" standard was adopted? This is an area that needs clarification by the Subcommittee before a complete evaluation of this option can be made.

Generally, the AAMC believes that the options paper does not make clear what the rationale is for eliminating the present exception. It is quite clear, however, that substantial administrative problems would occur if the exception is repealed.

Medical schools (and universities generally) and academic hospitals operate a variety of services that produce revenue whose purpose is to facilitate the smooth and efficient operation of the institution. These include campus and hospital shuttle buses, vending machines, parking lots, dormitories for physician residents, gift shops and cafeterias. These are not undertaken to produce revenue for the institution, but rather to serve the continued functioning of the organization. Repeal of this exception would not eliminate the need for these activities, or change their relationship to the exempt mission of the organization. The difficulty brought on by the repeal of the "convenience exception" would be due to the loss of its administrative benefit -- both to the exempt organization and the IRS. We believe that repealing the "convenience exception" will increase the need for the IRS to litigate questions of relatedness, a situation that we feel is in no one's interest.

Treatment of Taxable Subsidiaries

The AAMC has concerns over two options included in this area:

- the aggregation of income and activities of controlled subsidiaries in order to determine if the primary purpose of the parent corporation is a tax-exempt purpose; and,
- provide that a controlled subsidiary's income can be no less than its UBIT would have been if the income-producing activity had been directly carried on by the exempt parent organization.

On the first option, we believe that there is no justification for aggregating the activities of a separately incorporated, for-profit entity to tax-exempt parent -- especially when there is separate management and operation between the bodies. For-profit subsidiaries are, by their very nature, tax paying entities and were established as such because of the differing nature of their activities from the parent. To compare the activities of the two for purposes of determining the nature of the parent is contrary to the whole notion of establishing a separate taxable organization. We feel strongly that the proposed option overall contravenes basic principles of taxation, simply to resolve what is a tax accounting issue that could be settled more appropriately by regulation. We reject this notion and urge that it not be included in the Subcommittee's final recommendations.

With regard to the second option, we see no basis for requiring exempt organizations to make such a determination (the option paper contains no rationale for its application). Moreover, the AAMC believes that this is a wholly unworkable rule -- how, for example, would the fact that if the subsidiary was a tax-exempt entity, it would be unable to deduct rents, royalties or interest paid to the parent be taken into account? Here again, we feel that this is an attempt to solve through statute what is essentially a tax accounting problem, and in doing so disregard the basic principles of income taxation. We believe that the Subcommittee should focus its attention in this area on compelling the IRS to adopt consistent and workable regulations regarding treatment of the income of taxable subsidiaries and exempt parents.

Allocation Rules

The press release states that for exempt organizations that use a facility or facilities for exempt as well as unrelated purposes, a deduction against unrelated business income would be allowed only for a proportionate share of the direct operating costs of the facility. General overhead or depreciation on the facility would not be deductible.

We believe this option is a response to questions raised by the IRS over whether some exempt organizations have been allocating a disproportionate share of overhead costs to unrelated activities. If this is true, then the most appropriate response would seem to be an administrative action by the IRS detailing more precise allocation rules, just as similar rules for for-profit concerns have historically been expressed.

The Subcommittee proposal raises the question of how the application of deductibility rules of for-profit entities apply to exempt organizations subject to UBIT. If what are allowed to be deductible costs for non-exempt businesses are not permitted for exempt organizations, then it is clear that the tax burden on the latter would be greater. If the reverse situation were the case, if taxable concerns were perceived to be claiming excessive deductions, the response would most assuredly be to amend the regulations to clarify the rules for deduction -- not tax such businesses on a gross income basis. To make such a requirement of the tax-exempt sector, as the Subcommittee has done with this option, is not consistent with the basic principle of taxing only net income. The AAMC doubts that this is the Subcommittee's intent and urges that this proposal be rejected.

Again, the Association appreciates having the opportunity to comment on these options and applauds the decisions of the Subcommittee to hold an additional hearing on the public comments later this spring. We are anxious to continue working with the Subcommittee as this issue moves forward. Should you have any questions, please contact Mr. James Terwilliger of the AAMC staff at (202) 828-0525.

AAU

Association of American Universities

April 15, 1988

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
242 Cannon House Office Building
Washington, DC 20515

Re: Unrelated Business Income Tax:
Response to Discussion Option on Royalties

Dear Mr. Chairman:

The Association of American Universities, an organization representing 54 of our nation's leading research universities, and the Council on Governmental Relations, which represents 129 institutions primarily in the realm of federal regulation as it affects research universities, are pleased to endorse the comprehensive submissions of the American Council on Education (ACE) and the Independent Sector. We would like to take this opportunity to reinforce the comments of both ACE and the Independent Sector, underscoring an issue of particular importance to our combined membership–the treatment of royalty income.

The option with which we are greatly concerned would tax the passive income that tax-exempt organizations derive from royalties on licenses they grant for-profit businesses to use property created by the tax-exempt organization. This proposal is particularly troublesome to research universities for two important reasons: It breaches the principle that charities and all other tax-exempt organizations should be exempt from tax on passive income; and it violates that principle in a way that would be seriously detrimental to the ability of universities to engage in a type of activity vital to our nation's research efforts and international competitiveness–by taxing the transfer of technology.

The royalty proposal is inconsistent with the fundamental concept of UBIT, which is to create an exception to the general rule of exemption only when charities and other tax exempts engage in *active* businesses (and then only if the businesses do not contribute substantially to their exempt purposes).

Furthermore, except as noted below with respect to technology transfers, we would in general support elimination of the exception for net profits royalty arrangements, notwithstanding the fact that narrowing of the royalty exception is likely to have a significant adverse impact on a number of universities.

We believe very strongly, however, that there is a compelling need to preserve the royalty exception as it applies to college and university technology transfers, including the licensing of intellectual property created or developed in the course of research. Technology transfers have traditionally been accomplished–and are best accomplished–through a licensing or royalty arrangement. Depending on the specific circumstances, those arrangements take different forms, including lump-

Suite 730 • One Dupont Circle • Washington, DC 20036 • 202/466-5030

sum payments, running royalties based on sales, and in some cases, the sharing of net profits. The interests served by excluding such royalties from the tax are not simply interests of the higher education community. There are significant national interests at stake, as indicated by the adoption of legislative and regulatory policies that encourage technology transfers; we hasten to add that there are substantial business interests at stake as well, since many licensees on university patents are actually small businesses.

It is widely recognized, within the industrial sector and the government, that university technology transfers serve critical national and business needs, and that any disincentives to such transfers should be eliminated. Creation of new and substantial tax disincentives, in the face of this consensus, and our national drive for international competitiveness, would be a harmful and counterproductive step.

Sincerely,

Robert M. Rosenzweig
Robert M. Rosenzweig
President
Association of American Universities

Milton Goldberg
Milton Goldberg
Executive Director
Council on Governmental Relations

AAUP THE ASSOCIATION OF AMERICAN UNIVERSITY PRESSES, INC.
One Park Avenue, New York, N.Y. 10016 (212) 889-6040

April 15, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, DC 20515

Dear Mr. Chairman:

Thank you for inviting the public to comment on the discussion options regarding the unrelated business income tax (UBIT) which are under consideration by your committee.

It may help to put our observations in the correct context if we start by making a few comments about the American university presses.

The more than 80 American university presses which are members of this association vary enormously. Some are long-established, while others are only a few years old. Some produce hundreds of publications each year, while others publish only a handful. Some specialize in scientific matters, others concentrate on the humanities, while still others are particularly active in the fields of regional history and culture.

Collectively, they form the country's principal means of disseminating scholarly research in the arts, humanities and sciences. Many important but "uncommercial" titles would never be produced if it were not for university presses. Not only are they willing to publish loss-making titles, but they are prepared to keep them in print and available for use long after purely commercial considerations would have mandated their destruction. In some disciplines, university presses are virtually the only active publishers and it is difficult to envisage the condition of regional publishing without these presses, and particularly those of the state universities.

The university presses are a priceless national asset, but a financially fragile one. Nearly all university presses incur operating losses and many survive only with the help of grants and subsidies. In this environment, the benefits of tax-exempt status (including postal savings) are of enormous significance.

Turning now to your discussion paper, we have to admit that we are unclear concerning the committee's intent on certain issues. However, some of the options are sufficiently disturbing to merit our writing to you even though our concerns may not, in fact, be relevant to the subcommittee's actual interests.

The first and most important source of our uncertainty stems from 1. "Substantially Related" Test and its subsection dealing with gift shop and bookstore income. After presenting some options relating to on-premises sales, your paper goes on to discuss applying UBIT to "income from all catalog and mail/phone order or other 'off-premise' sales."

This can be read so as to apply solely to museums and other organizations which sell substantial quantities of goods to people visiting their premises. This interpretation would be a source of concern to some of our members, but to nothing like the same extent as the alternative interpretation of regarding the off-premises option as applying to all off-premises sales. This would have the effect of subjecting to UBIT virtually all publishing sales, including those of the university presses which have long benefited from tax exemption. It is difficult to imagine the consequences of such a change but it would certainly damage university presses, and, in doing so, weaken the nation's educational, intellectual and cultural fabric.

It is unlikely that this option is intended to be read in this way but, in the absence of any further information, we must register our extreme concern about the possibility of UBIT being applied to all off-premises sales.

While our uncertainty concerning the off-premises option is the most important single reason for our responding to your invitation to comment, there are a number of other options which would, or could, affect American university presses. Once again, the uncertainty derives from a belief that we may be misunderstanding the true meaning of some of these options. Until these points are clarified, we are reluctant to comment but it may be helpful for us to raise some of the questions which are troubling us.

- Are we correct in thinking that the application of the Allocation Rules would result in tax-exempt organizations paying higher taxes on unrelated activities than commercial organizations performing the same activities? If so, is this the intent?
- Would the 'direct advertising costs" to be set against advertising income include the ordinary and necessary expenses of advertising sales or would they be more narrowly construed?
- What is the difference between the "substantially related" test and the "directly related" test?
- Is the suggestion of having each income-producing activity stand alone intended to facilitate the selection of revenue-generating items from among a much larger number of similar items which lose money?
- Would the suggested tax treatment of royalty income mean that the sale of publishing rights would be taxable?

We have passed copies of your request for public comments to our members and I have no doubt that many of them will write to you and to members of your sub-committee to express their views. This is an extremely important issue for university presses and I am confident that you and your colleagues will give careful consideration to their comments.

Yours sincerely,

E. H. Phillips

E.H. Phillips
Executive Director

Comments of the Association of Art Museum Directors

I, Richard E. Oldenburg, President of the Association of Art Museum Directors, respectfully submit these comments on behalf of that Association, to express its great concern over the potential changes in the tax law provisions on the Unrelated Business Income Tax ("UBIT") as set forth in the discussion options recently issued by the Subcommittee on Oversight, Committee on Ways and Means.

The Association of Art Museum Directors is comprised of the directors of 150 of our nation's leading art museums located in 42 states. The museums represented by the Association qualify as tax-exempt entities organized and operated exclusively for charitable or educational purposes under section 501(c)(3) of the Internal Revenue Code. These museums have as their purposes encouraging and developing the appreciation and study of the visual arts, instructing the public, and enhancing public awareness and interest in art.

Museums traditionally have fulfilled this educational mission not only through special exhibitions and exhibitions of permanent collections, but also through libraries, education and study centers, and through a number of other activities. These activities include the publication of scholarly books and catalogs relating to collections and special exhibitions; the organization and production of programs and activities such as guided tours, lectures, films, video tapes, slides and brochures; the creation of books, programs and objects especially geared to instructing children; the sale of reproductions, objects, authoritative books on works of art in and related to collections and exhibitions; and the provision of other items which serve as a means of making the museums' collections and art scholarship better known, understood and appreciated by the public.

For most museums, the cost of providing their educational programs to the public far exceeds the revenue from those programs. For example, the price of admission does not cover the pro-rated cost of an individual's visit to the institution. In fact, preliminary results of a recent survey of our institutions indicate that the charge for the average adult visitor is $2.69 and that the average operating cost per museum visitor is $18.82. Museums have long had to subsidize their programs with private and governmental funding and earned income from such sources as admissions, membership and bookstore sales. In this context, any diminution in revenue is devastating.

The Association is alarmed by the proposed tax changes outlined in the options since these changes clearly threaten to erode museums' essential sources of revenue, which they employ to fund their operations. For the most part, our institutions operate at best at breakeven, or at deficit levels, due to increasing costs of building operations, security, insurance, and labor. For example, many of our institutions' insurance costs have more than doubled over the past three years. At the same time, government and other sources of funding have not kept pace. The imposition of tax on our related activities would greatly increase the already existing financial burdens on our institutions. The inevitable consequences would be major reductions in museum programs serving the public. Rather illogically, government funding sources would soon be pressed to give additional support to arts institutions to replace crucial revenues withdrawn as tax payments.

The Association is particularly concerned with the first option--which proposes either to change the current "substantially related" test to a "directly related" test, or to retain the "substantially related" test but impose UBIT except for certain on-premise sales or de minimis mail/phone order and catalog sales, therefore essentially declaring that many museum store activities are "inherently commercial." This option not only threatens to impose a tax on museums' programs which have been central to their educational mission, but also would place an onerous administrative burden on the institutions. We have several specific objections to this option.

First, the Association believes that it is difficult to draw the line, set forth in your example, that "UBIT would apply to income from a museum shop sale of a general art history book," presumably because a general art history book does not "relate to the organization visited." If such a book includes information and/or reproductions on several works or artists represented in a museum's collection, would UBIT apply or not?

Books which relate to and include materials from the collection and which explore art history in a greater context than offered in a particular museum certainly enhance public awareness, complementing the content of both specific exhibitions and collection installations and catalogs. For many visitors, particularly foreign and out-of-town visitors, museums create the only locations where an individual is likely to purchase such a book or other material. The purchase is made as part of the museum experience in the context of the art which has just been observed. It is questionable whether the same sale would ever be made in another store in the area, were the museum not to offer the book. It is also hard to imagine such a sale as not being related to the core function of the museum.

Museums frequently hold book inventories longer than commercial enterprises, and they are able to make available to the public a greater scope and variety of books than can be found elsewhere. In fact, in many locations, museums provide the only place where general art and art history books are sold.

Museums also perform an important and instructive service for the public in their selection of books. Generally, book selection is either made or reviewed by museum curators. Consideration is given to the level of scholarship and to the provision of a balanced view of art and/or art history. This fundamentally educational role is directly in conflict with the narrow view proposed in the first option.

Second, it is unclear from this option whether a museum would be taxed on an exhibition catalog which it continued to sell after the close of an exhibition. We urge you to consider the core educational purpose which these catalogs serve as the only formal documentation of an exhibition available for reference and understanding once the exhibition closes. We, therefore, find it difficult to recognize an "unrelated to the organization visited" classification for such clearly related material.

Third, the Association finds the language "sale of any article of an educational nature purchased at an on-premise gift shop which relates to the organization visited" to be ambiguous. We are concerned that, as with books, this language could result in the application of UBIT to various educational tools because they do not relate specifically to a given organization. For instance, certain items have been developed to help children to enjoy and learn from art museums, through understanding art, form and color. As with books, in many instances the objects which do not relate specifically to the institution visited serve to enhance the visitor's experience and expand the visitor's understanding of the art on view.

Fourth, the Association does not understand the rationale under which off-premise sales would be "inherently commercial" unless de minimis. Catalog, mail order sales, and other off-premise sales serve to extend the ability of institutions to broaden the public's awareness of their exhibitions and other programs and publications. Indeed, sales beyond the confines of a museum help to establish and reinforce the national and international following for many of our institutions. Through these sales, museums can reach and educate a much larger public than their actual attendance.

Presumably, many people use catalog and mail order purchases of books and objects for precisely the same reasons as with purchases made on premises--to provide a continuing reference to an exhibition and/or to provide further understanding of art appreciation and art history. We query whether these sales are less "educational" or less "substantially related" than the same sale at a museum. The fact that revenues are produced, we believe, should not be determinative in any way. For the museums, the revenues generated by these sales help to subsidize and extend their fundamental educational mission. To the federal government these revenues would be de minimis.

In conclusion, the Association respectfully urges you not to adopt the first option for the reasons discussed. Rather, we urge you to retain the current "substantially related" test. That test as applied, in focusing on the nature and scope of, and motivation for activities, and in requiring a nexus between the item sold and the institutions' tax-exempt purpose, provides a manageable measure for museum activities while limiting their efforts so that they do not compete unfairly with private entities.

Regarding the option on royalty exclusion, we note that the current law would be retained for products directly related to the exempt function. We urge you to keep a broad definition here of "related to the exempt function" to allow museums to be involved, with a royalty exclusion, in the development of general museum educational tools such as educational kits or study aids, which might go beyond the related test now under consideration by your committee. We also urge you to retain the royalty exclusion for licensing of museums' names or logos, an area which we believe does not compete unfairly with private enterprise.

The Association is also concerned about the proposed changes in the allocation rules which would disallow the allocation of general overhead and depreciation to facilities used for exempt purposes as well as unrelated business purposes. Many non-profit institutions, in their financial reporting, reflect defined overhead allocations and depreciation as part of their store operations. In doing so, a truer picture of the overall costs of operation is portrayed. The practice of allocating overhead and depreciation is consistent with financial reporting of private commercial businesses. It would be illogical to treat non-profit educational institutions less favorably than the latter, and it would result in confusion and inconsistency in financial reporting. We, therefore, urge you to retain the current regulations regarding allocation of costs.

Lastly, some of the museums which are members of the Association have concerns with the application of UBIT to other specific areas addressed by the options such as advertising in programs and publications, travel and tour services, list exchanges and rentals, and food services with entrances outside of the institutions, and the possible interpretation of the option to include regularly scheduled fundraising events which occur more than once a year. We are deeply concerned about any erosion of income which these changes may cause. We are also concerned that the administrative accounting burdens which would be placed on the institutions appear to be tremendous, and this particularly should be considered in view of the modest impact which we believe all of these options together would have in raising tax revenues. We have not, however, had an opportunity to poll our members or to analyze these other options in depth. The Association respectfully requests that it be given further opportunity to comment on these other areas, as well as on any new proposals your committee may make before a change in any area is finally proposed.

Moreover, we note that these discussion options go considerably beyond the Treasury recommendations. Also, the latter recommendations were accompanied by a strong assertion that efforts should be taken to collect more detailed information about the issues discussed. We are also aware that the Internal Revenue Service is undertaking a number of taxpayer audits and surveys in the area of UBIT to determine whether presumed abuses actually exist, also examining whether non-profit activities do, in fact, compete unfairly. We are concerned that the present proposals may assume facts not confirmed and would urge you to give further consideration to the viability of the current standard before repealing or revising it.

On behalf of the Association of Art Museum Directors, I thank you for your attention to these serious concerns.

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625 N. MILWAUKEE STREET

April 15, 1988

Committee on Ways and Means
Subcommittee on Oversight
Rep. J. J. Pickle, Chairman
1102 LHOB
Washington, DC 20515-6350

Dear Chairman Pickle:

This is in response to your Committee's press release of March 30, 1988 in which the Subcommittee commendably seeks to improve tax collection under the unrelated business income tax provisions of the Internal Revenue Code.

We represent the Association of Business Publishers, comprised of approximately 600 member-periodicals circulated nationally and internationally to scientific, financial, industrial, medical, and professional trade journal readers. Many of them compete with non-profit periodicals. When Section 513(c) (Advertising, etc. activities) was enacted by Congress in 1969, the American Business Press, now known as the Association of Business Publishers, testified in both the House and Senate on behalf of that landmark legislation.

Since the law passed in 1969, we have observed attempt after attempt by non-profit organizations to avoid the tax through accounting devices. These accounting devices have been centered around deducting advertising profits from circulation income, among others.

A proposal to allow deductions for only direct advertising expenses, as your press release proposes, is indeed a step forward. But based on past history we can conceive of a variety of arguments centering around the word "direct." For example, a periodical is circulated to its readership which constitutes the audience for advertisements. Will it be claimed that the total cost of the magazine is thus an advertising expense, as was recently claimed by the American Medical Association in AMA v. U.S., in District Court in Chicago.

In the AMA case, there is no clear court decision. However, a direct relationship test is certainly preferable to what is now on the books in the current regulation pertaining to advertising profits.

The Association of Business Publishers believes that a level playing field for both non-profit and for-profit periodicals, providing fair competition, would be created on the following basis:

> If a periodical carries advertising, then all its income, whether circulation or advertising income, should be taxable, because it is an advertising medium and not an editorial publication fulfilling a tax-exempt purpose. There is no requirement that a periodical carry advertising. If the publication carried no advertising, it would be tax-exempt.

As the Committee fashions its hearings, we would very much appreciate the opportunity for member publishers of ABP to testify (1) as to the nature of the competition they continue to face (2) as to how the current regulations can be avoided and (3) how the forward step the Congress took in 1969, after much controversy, can be strengthened to eliminate tax avoidance devices.

Sincerely,

Robert A. Saltzstein
General Counsel
Association of Business Publishers

cc: William Gorman, Gorman Publishing
 Chairman, ABP
Richard Moeller, President Edgell Commications
 Chairman, ABP Legal Committee
William O'Donnell, President, ABP

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

RE: House Ways and Means Committee, Subcommittee on Oversight Request for Public Comment on Options Relating to the Unrelated Business Income Tax

Dear Mr. Leonard:

Throughout the 20th Century our country's approach to higher education has looked to the college union to act as the "living room" for community life. Particularly since World War II, with the phenominal growth of public higher education, colleges and universities have needed to expand the original living room concept to become more of a community center with all of the attendant services and programs that communities from 5,000 to 50,000 required. While some states initially provided varying levels of financial support to these college unions, since the mid 1960's states have required college unions, and other "auxiliary" services to be totally self-supporting. In many instances these units generate sufficient funds to partially support other critical campus functions.

While the structure of private colleges and universities differ from that of the public sector, the college union operates essentially in the same way in both settings. That is, they support their facility and operating costs through student fees, fees for services and items held for re-sale.

The Association of College Unions-International is the premier professional association for those of us in the college union profession. Our Association has been closely tracking the discussions surrounding Unrelated Business Income Tax (U.B.I.T.) for a number of years. Last year we developed a formal position on this and related topics. In so doing we urged upon our membership three concepts:

- Develop strong ties with your community's chamber of commerce, downtown business association and/or other appropriate bodies.
- Develop clear campus policies on your out of classroom activities. Have a clear understanding of why you engage in any given program and the benefit that the college/university community derives.
- Fairly report and pay all U.B.I.T.

ACU-I was founded upon the premises that the true value to the general population from higher education is the development of the whole person. The research supporting the benefits both to student retention, and the societal benefit of one involved in the activities that are planned in and occur in the college union is irrefutable.

The underlying concern for ACU-I as we review your "discussion options" is the potential impact on the educational, recreational and service programs found in the modern college union. While it is difficult to describe the typical college union, since a major facet of our success is our ability to be what our campus requires, there are a set of programs and services that are included within the college union concept. Some of the most typical are:

- Ticket offices, check cashing services, campus wide information centers, room reservations for all non-academic functions
- Bookstores, food services, computer stores, travel centers, banks, barbershops, post offices, graphics
- Music listening lounges, study centers, T.V. lounges, typing/computer clusters
- Student goverance, student organizations, student newspapers, accounting services for these functions
- Student programming bodies providing speakers, fine arts, concerts, film series, dances, group travel
- Craft centers, recreation centers, leisure learning programs, art galleries

- Meeting rooms
- Administrative offices for the college union, dean of students, international student centers, alumni association

The specific mix of programs and services is dependent upon time and place. Each campus strives to support those elements that are most essential to the development and success of it's academic program.

In looking at the Oversight Committee's systematic review of U.B.I.T., ACU-I appreciates what we perceive to be the members concern for the outcome of any changes of existing statutory sections. It is our belief that it is not your intent to impair the ability of these essentially self-supporting components of our colleges and university's to provide the services that they need at a place, time and price that enhances the success of the academic endeavor.

We will confine our comments to those items which seem most important to our sphere of operation. In some instances our comments may be in the form of a question. This occurs due to our uncertainty as to what is meant by a particular option:

"Substantially Related" Test:

- If replaced by a "directly related" test we fear that a large body of the out of classroom activities which now must often support themselves via user fees may fall into the taxable arena. Most of us are struggling now to financially support critical cultural, social and recreational services. Similarly, many of our service components (food services, graphics centers, box offices, etc.) may well fall outside of this test. Were this to occur could have a profound impact on the what the college union can provide to enhance the academic community.
- Looking at each income producing activity separately seems close to the fragmentation concept now used by the Internal Revenue Service. If this is your intent, we would hope that the capacity to offset the loss in one component of a given service/program against those similar efforts which may occasionally generate surplus revenue be allowed.
- The" substantially related" test plus exceptions is preferred to a "directly related" test and does present the setting for us to set-out more specific concerns:
  A. Gift Shop/Bookstore income: the alumni (former students) and parents of current students are an integral part of the college community. Due to time and distance often the only way to enable them to avail themselves of our memorabilia is through catalogs, phone and off-premise sales. We suggest that these individuals not be treated as separate from their college community.
  B. "Income from certain Health, Fitness Exercise...": we assume that this does not refer to the recreation and leisure learning programs prevalent on college campuses.
  C. "U.B.I.T. to travel and tours services": we assume that travel and tour services operated by student body organizations would also be covered by this exception.
  D. "U.B.I.T. to adjunct food sales": we assume that "on-premises" refers not only to the central campus facilities, but also athletic facilities, system administrative offices, off-campus official residences, off-campus conference facilities and the like. In order to foster community relations, many campuses host community night dinners, madrigal dinners and the like. To achieve their intended purpose, these events must have significant community (i.e. not students, faculty or staff) participation. Will a de minimas rule apply here too?
  E. "U.B.I.T to hotel facility income": again, will a de minimis test apply? Some of our member institutions provide limited hotel services as an adjunct to what is essentially a conference/extended learning center. When rooms are available, in almost all cases the guests using these facilities are present at the request of the university (ex. guest lecturer, candidate for a position, etc. or a guest of a specific member of the campus community).
  F. "U.I.B.T. to advertising income": will the existing exemption for student newspapers, yearbooks, directories and other student publications still exist? Similarly, will the exemption for intercollegiate athletics continue? If these exceptions are removed, many of our more financially strapped members may be compelled to discontinue these long term campus programs.
  G. Exception "L" cannot be evaluated at this time since we do not know what programs are "inherently commercial."
- It would be our preference to continue to use the substantially related test.

Convenience Exception

It is difficult to fully respond to this option without having first resolved the nature of the substantially related test. Even if one assumes that the latter is not altered, ACU-I believes that their could be major damage to the total out of classroom program if the convenience exception was abolished.

Many college unions today are able to support their total physical plant because of the funding that is transferred from their bookstores, food service and other similar activities. While an intricate cost accounting system most often will be able to justify these transfers as a fair rent, the cost of implementing such a system and the principals underlying this approach are not congruent with the structure of the academic community.

It is our understanding that exceptions to the Federal Income Tax Code are rooted in the belief that the income foregone is more than compensated for by the gains to the country as a whole. It is the societal benefit of higher education that allows this arena to be granted an encompassing exception in the first place. The convenience exception is a natural extension of this concept because at its root it enhances the total academic endeavor.

Those students, faculty and staff who use the many college union services enumerated earlier are able to maximize the time that they spend focussed on their primary relationship to their campus. Furthermore, the total educational and service program provided by a college union expands the value of the classroom and the laboratory.

To remove the convenience exception at this time could cause a significant upheaval in financial base of many both directly and substantially related programs. To do so at a time when many colleges and universities are facing funding difficulties seems unduly harsh and not in the best interest of society in toto.

Other Items:
There are others in the higher education community who are far more knowledgeable as to item III-IX. Many of these items contain tax intricacies that our association does not generally address. There are a few items that we would like to provide some thoughts on:

- Royalty Income: many college unions and student organizations have developed well recognized programs. The sale of T-shirts, visors, and similar items with the event name, logo, year, etc. may provide a small, but critical mass of funding for these major events (ex. annual battle of the bands, annual crafts fair, Black History Week, etc.). While the revenues generated are only a fraction of other royalty income, it seems that if the campus worked with an off-campus vendor to produce and market these items U.B.I.T. would now apply. We wonder if the effort in accounting for this income and the potential total tax revenues outweighs the value of the support to these campus events?

- Allocation Rules: the primary purpose of the meeting and general use space in the college union is to enhance the out of classroom program. Most of us have analyzed our campus use patterns and determined certain times where facilities can be made available to off-campus users. In most cases these users are governmental agencies, non-profit community organizations and the like. Allowing this usage often helps to cement positive campus and community relations.

  The proposed rule change seems reasonable as far as it goes. We are concerned as to the totality of what is meant by a "direct operating cost." While we have no difficulty with excluding a percentage of central management cost, we would anticipate that the maintenance and utility costs would recognize the ancillary expenses associated with conducting a given function. That is, if due to the U.B.I.T. activity a college union needed to add reservations staff, custodial staff, an accounts receivable clerk, etc. then these expenses would be seen as direct operating costs.

  As in the for profits sector, some institutions have found that to successfully serve this clientele they must augment their staff and equipment. In the cost/benefit analysis of a given program management determines that new income will at least off-set the added cost. As with the for profit sector, it seems appropriate that the added expenses should be deductible.

- Miscellaneous: for decades college unions have contracted with for profit concerns to provide specialized services on campus. The 1980's has brought to our colleges and universities a new era of privitization. In leasing space to a for profit concern to deliver a particular service a major campus community concern is that the return on investment of the lessee is not excessive. This has spawned a variety of rental agreements. While most of these agreements continue to be rooted in a typical yearly guarantee or per square foot charge, some get much more complex. At the same time these agreements are clear in stating that the parties are in no way enterring into a joint venture. Two typical examples may be instructive.
  1. College X contracts with Promoter Y for the latter to produce a concert on campus . Amongst items addressd in the agreement are the means for advertising, ticket prices, etc. The agreement calls for the Promoter to cover all expenses and to receive the first $5,000 of net income. The remaining net income will be split between the parties equally.

2. University A has contracted with Company B to provide food service to its resident students. It is agreed that Company B will cover all expenses except for specified facility costs. The agreement also provides that the University will receive an annual rent of $50,000. Company B shall receive the first 5% of all net income. Any remaining net income will be divided equally.

While we do not believe that either example falls within your language for subsidiaries and joint ventures or royalty income, we would appreciate clarity on these arrangements.

Should it be determined to apply U.B.I.T. to these types of agreements the solution in most instances will simply be to re-structure the terms and develop another vehicle to limit any entity from generating excess income.

Summation
ACU-I appreciates the detailed process that the subcommittee is using to determine the appropriate configuration of U.B.I.T. Our contacts with persons much more familiar with the entire discussion for the past few years indicates that your review of this topic is not revenue driven. Instead this review is a re-evaluation of the "balancing test" of the positive impact of the tax exemption provided to non profit organizations versus the potentially negative impact to the for profit sector.

As a profession dedicated to providing essential services and programs to our campus community we address U.B.I.T from the perspectives of wanting to preserve our capacity to meet our mission. While many elements of each college union's mission are similar, there are also differences based upon each institutions needs.

Speaking as a person who currently works at a large, public comprehensive research institution (the University of Houston) and whose last position was at a medium size public state university in a college town (California State University, Chico), the charge to these institutions from their state in terms of providing service to the general population is much different. As an urban university, my current campus provides critical support to our city and state through focussed research efforts. At my prior campus, the University was the cultural center for a very expansive multi-county region. In balancing the outcome of alterring exisiting U.B.I.T. language we urge you to look at the practical impact of each change.

Our college unions offer a broad set of programs which will not be assumed by the for profit sector if the income that we now receive is diminished in any significant way. We seriously doubt that the for profit sector will offer poetry readings, student video networks, study lounges, computer clusters, student volunteer programs, and the many other programs found in our facilities. The survival of these programs depends upon the capacity of those functions that can be self-supporting, and in a few instances can generate excess income, to do so. Thus while the impostion of additional taxes on certain facets of our bookstores, food services, etc. may not impact these operations directly, in many cases it will remove funding from other essential out of classroom services and programs. To do this seems to benefit neither sector.

Sincerely yours,

Mark Bookman, Chair
ACU-I Business Affairs
Task Force

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MB/ceo

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April 15, 1988

Honorable J.J. Pickle, Chairman
Oversight Subcommittee
House Committee on Ways and Means
1105 Longworth House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Pickle:

I am writing on behalf of the Association of Junior Leagues in response to your request for comments on the unrelated business income tax (UBIT) options under discussion. The Association appreciates the care with which you are considering changes on the UBIT and are grateful for the opportunity to comment.

As a member of the Independent Sector and of the National Assembly of National Voluntary Health and Social Welfare Organizations, we support their comments and urge you to give them careful attention.

The proposed revision of the "Substantially Related" test will significantly impact the Junior Leagues - particularly those Junior Leagues who run Thrift Shops. Thrift Shops have substantially all their goods donated and substantially all their work done by volunteers. The income generated from Thrift Shops allows Junior Leagues to support their community programs which range from Day Care Centers for Children of the Homeless, to Teen Pregnancy Prevention Programs, to Shelters for Battered Women, to Substance Abuse Programs. In addition, these Thrift Shops supply inexpensive, quality goods to individuals and families, many of whom are living on very low incomes.

"Inherently Commercial" seems to us to be vague and potentially confusing. All our Thrift Shops, for instance, are managed as efficiently and as business-like as possible. Does that make us less charitable?

The Association of Junior Leagues is an international organization of women committed to promoting voluntarism and to improving the community through the effective action and leadership of trained volunteers. The Association has 272 member Leagues representing approximately 180,000 individual members. Two-hundred sixty-two of these Leagues are in the United States.

We look forward to the continued opportunity to participate in the dialogue on options relating to UBIT as it moves through the legislative process.

Sincerely,

Peggy Pschirrer

Peggy M. Pschirrer
Acting Executive Director

APFC

ASSOCIATION OF PHYSICAL FITNESS CENTERS
600 Jefferson St.
Suite 202
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301/424-7744

JIMMY D. JOHNSON, Ph.D.
President

MAN/WOMEN OF THE YEAR

1977—Gerald R. Ford
1978—William Proxmire
1979—Jimmy Carter
1980—Eunice Kennedy Shriver
1981—George Bush
1982—Dr. Kenneth H. Cooper
1983—Ronald Reagan
1986—Coach George Allen

SPORTSMAN OF THE YEAR

1977—Arnold Schwarzenegger
1979—Bruce Jenner

HALL OF FAME
PIONEERS OF FITNESS

1984—Joe Weider
1985—Burt Goodrich
Vic Tanny
1986—Jack LaLanne

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Sport Psychology Laboratory
University of Wisconsin

Michael L. Pollock, Ph.D.
Center for Exercise Science
University of Florida

April 14, 1988

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

Dear Chairman Pickle:

The combined membership of the Association of Physical Fitness Centers, consisting of 500 full service physical fitness centers, respectfully urges the Committee to adopt the following language in place of the Subcommittee's discussion option I (C):

> Apply UBIT to income from certain recreation, fitness, exercise and similar activities except for fees received from the so called charitable classes, i.e. unemployed, senior citizens, military and youth.

This wording would place private, for profit fitness facilities on an equal footing with nonprofit entities such as the YMCA.

Sincerely,

Jimmy D. Johnson, Ph.D.
President

JDJ/co

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Richard Wood
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April 15, 1988

Congressman J.J. Pickle
Chairman, Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax:
Response to Discussion Options

Dear Mr. Chairman and Members of the Subcommittee:

On behalf of the Committee on Non-Profit Organizations of the Association of the Bar of the City of New York (the "Committee"), I would like to respond to your request for comments on the discussion options released by the House Ways and Means Oversight Subcommittee on March 31, 1988. The Association is an organization comprised of over 16,000 lawyers, most of whom practice in the New York City area. The members of the Committee are lawyers interested in the legal problems of non-profit organizations, including lawyers who act as general counsel to, or director of, such organizations, law school professors who study this area, attorneys who work in regulatory agencies, and private practitioners who represent non-profit organizations of various types. The Committee studies, reports on and proposes legislation which affects non-profit organizations.

The Committee believes there is a need to articulate the rationale for the changes which are being proposed. Not only is such a conceptual framework not explicitly stated in the Subcommittee's March 31 release but it is not implicit in the various discussion options. The Committee urges that tax policy regarding the unrelated business income tax ("UBIT") should be formulated with due consideration of the important public policies which underlie the concept of the charitable tax exemption and the related area of UBIT. In particular, the Committee is concerned by the policy implications of three discussion options: 1) repeal or alteration of the "substantially related" test, 2) changes in the allocation rules and 3) consideration of an aggregation rule in connection with taxable subsidiaries. Such changes could have an impact, not just on UBIT, but also on the issue of qualification for exempt status. Further, these changes could impact not just on the Federal income tax system, but far beyond it, in affecting state income, sales, real estate and other taxes, and such collateral areas as qualification for special non-profit postal rates. The likelihood of far-reaching effects amplifies the importance of the proposed changes and makes more vital the need to legislate with due consideration of policy concerns and with attention to predicted effect.

We know you and the members on your Subcommittee agree that privately-administered philanthropy makes an important contribution to our society. A delicate balance exists whereby current tax policy provides a healthy environment for the non-profit sector which is straining to respond to expanding public needs. We urge that changes in the tax law which would damage this important sector's health would not be in the public interest.

During the hearings held by this Subcommittee in June, 1987, the expressed concern was that competition between non-profits and for-profits was perceived as unfair. During the hearings, both the Internal Revenue Service and the Department of the Treasury advised that there was a need to collect data to determine whether there was in fact unfair competition and, if so, to determine the best way to remedy such unfairness. The Committee supports the current efforts to collect this information and suggests that legislative proposals should await the development and analysis of this data.

With these observations in mind, the Committee would like to offer the following comments on the discussion options.

I. "Substantially Related" Test

Two alternative but conflicting discussion options are suggested in relation to the "substantially related" test: repeal the test and replace it either with a "directly related" test or a test that would require each income-producing activity standing alone qualify as tax-exempt, or retain the "substantially related" test but impose UBIT on approximately eleven categories of activities which would be deemed inherently commercial, rather than charitable.

The Committee suggests that the first alternative should not be adopted without promulgating for consideration the parameters of the "directly related" test. It seems unwise to abandon the "substantially related" test, with which there is familiarity and which can be modified as appropriate, in favor of a new, unfamiliar and subjective test, without a clearer understanding of the benefits to be gained by such a change. It does not appear that the task of defining activities as those which are "directly", rather than "substantially", related to exempt purposes will be an inherently easier task or one that will necessarily produce a more equitable result. It is significant to note that the Department of the Treasury concluded that the "substantially related" test had conceptual merit and recommended no changes in this standard, but instead called for more detailed reporting to improve enforcement and compliance in the area, and to provide a basis for further review.1/

1/ Statement of Deputy Assistant Secretary of the Treasury, O. Donaldson Chapoton, (June 22, 1987) (the "Treasury Statement").

The suggestion that each activity standing alone would be analyzed to see if it separately qualified for tax exemption is a striking departure from current law, one which would appear to be difficult to administer and appears conceptually unsound. It is not clear why it is preferable to view each activity on its own merits. The current law, which asks whether each product or service contributes importantly to the accomplishment of charitable or educational purposes, appears to be an approach that is more consistent with current tax policy of fostering charitable organizations.

The second discussion option, which would retain the "substantially related" test, also proposes to impose UBIT on certain activities which are labelled as "inherently commercial". This proposal is conceptually unsound and inconsistent with the "substantially related" concept. It sets forth a laundry list of activities deemed commercial on a per se basis without consideration of the context in which those activities are conducted or the relationship between the activity and the organization's exempt purpose. The activities listed appear to be no more than a summary of those areas about which witnesses complained during the June hearings. They have no internal consistency and, thus, provide no basis from which one could extrapolate what the rationale would be for identifying what other activities would be treated as inherently commercial.

II. Convenience Exception

This discussion option suggests a repeal of the exception from UBIT currently granted to income earned from activities carried on primarily for the convenience of the members, students, patients, officers or employees of an exempt organization. The Committee is concerned that eliminating this exception could have a serious adverse impact upon the general public by causing a reduction in the level of services which exempt organizations, rather than unrelated for-profit entities, can most conveniently and appropriately render to their students, members, patients and others. This could curtail the ability of numerous institutions to pursue their mission of community service which forms the basis upon which society decided they were entitled to tax exemption. Although the potential harm which could be caused by the repeal is clear, the potential benefit sought by such repeal is not as evident. The Committee believes that the conceptual rationale for this exception is sound, and that refinement in the scope of this exception should only be made to remedy documented abuses.

III. "Regularly Carried On" Test

This discussion option proposes the repeal of the requirement that an otherwise unrelated activity be one that is "regularly carried on" before the income it generates will be taxable as UBIT, while noting that an activity that is not a "trade or business" would remain tax-free. Examples provided in the Subcommittee's description document indicate that annual "galas" would not be taxed, but an annual fund-raising circus would be. We believe this change would not result in leveling the playing field, one stated objective of UBIT. One-time or occasional activities of exempt organizations such as an auction or circus do not suggest the kind of frequency and continuity that must exist before it can be concluded that competition with full-time business endeavors exists. Further, the "trade or business" test does not appear to offer the kind of clear-cut guidance which both the non-profit community and the Internal Revenue Service deserve. The administrative burden which this change would impose upon exempt organizations and the Internal Revenue Service alike appears not to be justified by the negligible revenue or improvements in the tax system which would result.

IV. Tax Treatment of Royalty Income

This option would narrow the scope of the exclusion granted to royalty income; it proposes either to apply UBIT to royalties measured by net or taxable income or to apply UBIT to royalties for use of property which an exempt organization (or a closely-related organization) helped create, develop or market, if the product is not "part of the organization's exempt function". The Committee agrees with the initial Treasury recommendation that there should be further investigation as to whether any change to the royalty exclusion is warranted before such discussion options be given further consideration. If a change is necessary, however, the Committee believes that the first discussion option offers the better choice, as it is the more functional and reasonable. As observed by the Department of the Treasury, "when an organization shares in the net profits of a business, as opposed to the gross income or receipts, it is more akin to a partner in an active business than to a passive investor". Treasury Statement at p. 32. Further, if it is ascertained that the alleged practice of misusing licensing agreements is widespread enough to deserve attention, steps might be taken to tailor carefully an exception to the royalty exclusion which does not unduly inhibit the proper use of licensing agreements by exempt organizations.

V. Deduction from Taxable UBIT

The Committee concurs with the discussion option which suggests increasing the UBIT specific deduction from $1,000 to $5,000, especially since the deduction has not been raised since its introduction in 1950. We also concur in the phase-out of the deduction beyond the level of $50,000 in income in order that the benefit of the deduction be confined to small unrelated businesses. A limitation of the specific deduction to "activities directly carried on" by a tax-exempt organization, however, does not appear to be warranted; the Committee does not perceive a need to limit the deduction in that manner and is not certain what purposes or policies would be served thereby.

VI. Unrelated Debt-Financed Income

This discussion option would restrict the exception from UBIT granted for income from debt-financed property to only pensional [sic] funds, education institutions and title holding companies that make at least a twenty percent (20%) equity investment of their interest in the property. The Committee first notes no justification is given for limiting the tax exempt entities to which this exception applies. Further, no explanation is given for setting at twenty percent the equity interest which an organization must hold in property in order for income from that property to be exempt from UBIT. Thus, the Committee cannot support the proposal as it is presently stated.

VII. Subsidiaries and Joint Ventures

One discussion option proposes to re-define "control" of a taxable subsidiary by an exempt parent to be ownership directly, indirectly or by attribution of at least fifty percent (50%) of stock, by vote or value. In prior submissions, the Committee has agreed that the definition of a controlled subsidiary could be improved in order to minimize the ability of an exempt organization to avoid application of the UBIT to a particular income stream despite actual control of a subsidiary. Like the proposal outlined in the Treasury Statement, however, this discussion option is open to many of the same perceived abuses that the change is meant to eliminate.

Therefore, the Committee again suggests that consideration be given to the control test of I.R.C. § 482 and the regulations thereunder. In that test, "controlled" means "any kind of control, direct or indirect, whether legally enforceable, and however exercised or exercisable. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted." Treas. Reg. § 1.482-1l(a)(3). Moreover, the Committee still believes that the desired end could be achieved by focusing not only upon the definition of control but also upon whether the income of the taxable subsidiary is properly taxed.

The Committee disagrees with the discussion option which proposes the aggregation of the income and activities of controlled for-profit subsidiaries with those of the tax exempt organization parent for purposes of determining whether the primary purpose of the parent is the conduct of a tax-exempt function. This suggestion appears to stem from a concern that a subsidiary might be used to pursue an activity which, if run within an exempt organization, would constitute so large a part of its activities that its primary purpose would be the pursuit of an unrelated trade or business. However, as noted in the Treasury Statement, the Department of the Treasury was admittedly unaware of any instances of such circumvention.

Unrelated activities which are pursued in taxable subsidiaries are presumably taxed at the subsidiary level; no one proposes that such activities should be exempted from taxation. It is impractical and conceptually unsound, in order to assure proper taxation, to aggregate activities purposefully placed in a taxable subsidiary with those of an exempt parent in order to find "primary purpose". Moreover, adoption of this option would reverse the public policy which encouraged many exempt organizations to broaden the scope of services they provide to the public, in part by forming taxable subsidiaries, in order to foster better continuity of operation and care. For instance, hospitals and health care organizations have been urged in the recent past to expand the scope of the related services they perform for the public and have developed these services in taxable subsidiaries. To now aggregate these activities back into the parent at the risk of revocation of tax exempt status is unfair and contradictory. In addition, such a step would not serve any useful purpose. The Committee is concerned that one public policy, addressing perceived abuses in the area of unfair competition, is being pursued without due consideration of the important public policy furthered by the granting of tax exemption and the public clamor for the expansion of services.

VIII. Allocation Rules

This discussion option advocates allowing a deduction against unrelated business income generated by a facility used for exempt, as well as non-exempt, purposes of a proportionate share of direct operating costs of the facility such as maintenance, insurance and utilities, but not allowing a deduction for a share of the necessary and related indirect expenses such as general overhead of the organization or for depreciation. In previous submissions, the Committee has agreed that the allocation rules should be clarified, with a view to making them fair and economically rational. The discussion option does not achieve either of these objectives. Sound tax policy and consistency with other parts of the Code require allowing a deduction for an appropriate share of indirect expenses and depreciation. Thus, we agree with the Treasury Statement that a more functional method of allocation needs to be developed but we do not perceive any need for a restriction in the items of expense which may be properly allocated.

IX. Tax Information Reporting/Internal Revenue Service (IRS) Administration

The Committee agrees that more information is needed in this area. Accordingly, it supports the suggested options for change to the I.R.S. Form 990-T, for tax and informational return examination and for general studies. In particular, the option of a "short form" reporting method for small organizations, based on revenue, makes good sense.

The Committee would like finally to thank the Subcommittee for affording it this opportunity to express its views on the discussion options and for considering those views.

Respectfully submitted,

Carolyn C. Clark, Chair

Committee on Non-Profit
Organizations of the
Association of the Bar
of the City of New York

J. Sinclair Armstrong, Esq.
Allen R. Bromberger, Esq.
Vivian L. Cavalieri, Esq.
Robert Coulson, Esq.
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AUDIO HEARING AID CENTER
• 3915 W. STATE STREET
BOISE, IDAHO 83703 • PHONE: 208/345-1812

LAWRENCE J. HOUSE
Certified Hearing Aid Audiologist

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: UBIT System

Dear Honorable J.J. Pickle,

I would like commend the Subcommittee for proposing an excellent package of reform measures on the options regarding reform of the Unrealted Business Income Tax System that applies to nonprofit organizations.

I would like to encourage the Subcommittee to include all measures in its final report especially where UBIT applies to hearing aid sales income for nonprofit organizations.

Currently the Idaho Elk's Rehabilitation Hospital has been dispensing for profit for the past year, under nonprofit status. They claim to fit only the inpatient and direct doctor referrals. However, they recently hired a second Audiologist and are very aggressive within the medical community in regard to hearing aid dispensing.

I feel that their competition is healthy. I am not trying to limit their activity, as long as it is on the same tax basis and guidelines that I must practice.

Very truly yours,

L J House

Lawrence J. House

LJH/sb
cc

Audiology Associates

3228 Shrine Road
Brunswick, Georgia 31520
(912) 267-1569

RICHARD D. WRIGHT, M.S.
Clinical Audiologist
Hearing Aid Audiologist

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard,

We are aware that the Honorable J. J. Pickle (D-TX), Chairman of the House Ways and Means Oversight Subcommittee, has released preliminary discussion options regarding reform of the Unrelated Business Income Tax system that applies to nonprofit organizations. Included among these are several which apply directly to hearing aid sales by nonprofit organizations.

I would strongly encourage that the final regulations apply UBIT to all hearing aid sales income of nonprofit organizations. At present time nonprofit universities and speech and hearing centers are in unfair competition with other legitimate professionals in the industry. We feel that competition from an organization utilizing contributed income for federal funds should not undercut the private sector. We see this as a mushrooming problem in the hearing aid industry.

Your consideration of these views will be warmly appreciated.

Sincerely,

Richard D. Wright

Richard D. Wright, M.S.,CCC-A
Clinical Audiologist

RDW/ewa

Certified by the American Speech and Hearing Association and the National Hearing Aid Society;
State licensed as an Audiologist, a Hearing Aid Dealer, and a Hearing Aid Dispenser.

AUDUBON NATURALIST SOCIETY
OF THE CENTRAL ATLANTIC STATES, INC.

Founded May 18, 1897

CONSERVATION
ENVIRONMENTAL EDUCATION
NATURAL SCIENCE STUDIES

April 15, 1988

Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

Dear Congressman Pickle:

This letter is written to express the strong concern of our Society about many of the discussion options relating to the unrelated business income tax on non-profit organizations set forth in your release of March 31, 1988, which has just come to our attention. Enclosed is a leaflet describing the activities of the Society, which is an educational and scientific organization with some 10,000 members in the metropolitan Washington area.

Notably, the Society might be seriously affected by the repeal of the "substantially related" test because it maintains a bookshop to supply its members and the interested public with books and other materials and articles related to the Society's purposes. The bookshop has two locations, at the original headquarters in Georgetown, D.C., established 26 years ago, and at the present headquarters, a 40-acre nature center and preserve in lower Montgomery County, Maryland devised to the Society in 1968. Throughout the period involved, the Internal Revenue Service has accepted our compliance with the substantially related rule. We believe that this rule should be retained with appropriate enforcement.

Another of the proposals which would affect the Society adversely is that on travel and tours. The Society maintains a fairly extensive program of "forays" devoted to providing members and others with the opportunity of observing nature and the conservation situation in various parts of the North American area. However, the Society does not sell airline tickets, which are handled by travel agents on their normal commercial arrangements. In our opinion the ability of non-profit organizations to offer tours in their fields of activity should not be infringed.

It is requested that the Society be placed on your mailing list for any further releases by your Committee on the subject.

Sincerely yours,

Elting Arnold

Elting Arnold
Treasurer

8940 Jones Mill Road • Chevy Chase, MD 20815 • Headquarters Telephone: 301-652-9188

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Chevy Chase, MD 20815

Membership entitles you to:

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- Field trips — over a hundred free trips each year
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- Invitations to special programs and exhibits at Woodend, the Society's historic headquarters estate

The Audubon Naturalist Society of the Central Atlantic States is a nonprofit organization dedicated to conservation action and environmental education. Contributions, and dues in excess of $7.50 allotted to the *News* subscription, are tax deductible.

For more information call 652-9188

Discover . . .

Artwork taken from drawings by Frances Lee Jaques for *Spring in Washington* by Louis J. Halle, Jr. All rights owned by Audubon Naturalist Society.

AUDUBON NATURALIST SOCIETY
OF THE CENTRAL ATLANTIC STATES, INC.

. . . great blue herons fishing at Dyke Marsh

. . . rare trailing arbutus blooming in Rock Creek Park

. . . stalactites forming in the caves of the Appalachians

. . . piping plovers nesting at Chincoteague

. . . red foxes raising their pups at Woodend

Discover all this and more with the Audubon Naturalist Society

8940 Jones Mill Road
Chevy Chase, MD 20815
(301) 652-9188

Founded in 1897, our Society is one of the original independent Audubon societies and a pioneer in the linking of natural history studies with conservation activities. Our goal is to increase public awareness of the natural environment and to encourage participation in efforts to preserve and renew our natural resources. Environmental education programs for all ages and an active conservation program for this region are at the heart of the Society's work.

Explore . . .

Each year the Audubon Naturalist Society sponsors over a hundred field trips to unsurpassed natural areas from Dyke Marsh just south of Washington to the Great Smoky Mountains. Guided by our expert naturalists, you can enjoy the companionship of others who share your appreciation of the natural world while exploring the C&O Canal, Cape May on the Delaware Bay, New Jersey's pine barrens, the Chesapeake Bay, and beyond.

- Explore the varied woodland habitats of the Potomac River valley to uncover edible mushrooms, discover early spring wildflowers, and observe migrating warblers.
- Join our annual foray to Pennsylvania's rugged Laurel Highlands where you can learn about its interesting natural and human history.
- Come along on our Natural Heritage series to observe the effects on wildlife of different management practices in parks, refuges, and other natural areas.

Learn . . .

The Audubon Naturalist Society offers you and your family the opportunity to expand your knowledge of the natural world through year-round environmental education programs:

- Nature classes for children as young as age four and special programs for teenagers and families.
- Field trips and forays for everyone interested in investigating the flora and fauna, the ecology and geology of natural areas near and far.
- Natural History Field Studies, a complete curriculum of adult courses leading to a certificate of accomplishment through the USDA Graduate School.
- Audubon Lectures, bringing outstanding scientists to speak at the Smithsonian Museum of Natural History each month.
- Environmental education workshops for teachers and youth leaders.
- Voice of the Naturalist, a weekly recording of current and unusual bird sightings by and for our members.

You can also enjoy learning and sharing knowledge with others in a wide range of volunteer opportunities. Members work in our bookshops, run our Speakers Bureau, lead field trips, organize special events, and teach in our School Ecology Project for District of Columbia schoolchildren.

Protect . . .

Preserving natural areas is protecting a healthy environment for all of us. The Audubon Naturalist Society maintains a long tradition of community action to preserve wildlife habitats in our area:

- Society members, including Justice William O. Douglas, helped ensure preservation of the C & O Canal as national parkland some 30 years ago; today we help preserve and interpret its natural beauty.
- The Society joined in efforts to protect Dyke Marsh as a wildlife sanctuary in the 1960s; now we work to prevent use of herbicides in the Potomac River that would endanger birds feeding there.
- Rachel Carson was an active Society member when she wrote *Silent Spring*; today we inform homeowners about the risks of misusing pesticides and encourage right-to-know legislation.
- Members continue long-term environmental monitoring projects such as bald eagle surveys, breeding bird censuses, and Christmas Counts with unbroken records for over 40 years.

Woodend, the Society's 40-acre historic estate in nearby Chevy Chase, Maryland, is a haven for wildlife in the midst of increasing development. The Society manages the property to preserve a variety of habitats in woods, fields, and thickets. Woodend is open free to the public every day of the year.

ATE AUSTIN TESTING ENGINEERS INC.
2604 Dellana Lane Austin, Texas 78746 (512) 327-3405

April 7, 1988
1988-L-83

Robert J. Leonard
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Re: Filing of Comment for the Curbing of
Nonprofit Competition

Dear Sir:

This letter is being written to ask for your help in a matter that is seriously effecting and very important to small business. This matter is the unfair advantage of nonprofit competition in the laboratory testing business. Small for-profit business needs your support and leadership in curbing and reform from the nonprofit competition and the unrelated business income tax (UBIT).

Nonprofit competition has been for many years a serious threat to the existence of many testing firms. It is a serious problem that can no longer be tolerated. As a small business, I don't have a lobby. I don't have a cadre of lawyers. I only have a subcommittee and a pen to write with to defend my interest and those of my fellow testing laboratories. We must count on you to help push our ideas forward. I hope you will understand that it has taken us a long time to get to this point, a chance for meaningful reform through legislative action to adjust the inequities.

I know some have said, "Well we do not hear much for the small business laboratory....It must not be that important." Well it is! We have just been working, trying to stay in business. If one letter could bring forth the needed changes, to even persuade one person to help us with unflinching commitment, I hope it is this one.

I understand that there is a discussion option to modify rules applicable to organizations that quote "Test for the public safety". This is unacceptable, and I view it as a license to steal by using loopholes in rules that should protect and not show favoratism. This exemption should be deleted. We as a group test items, products, and mediums that effect public safety, whether it is air, water, hazardous materials, construction materials, cosmetics, food or telecommunication components.

Please carry my message forward and help us get this reform when it is finally our chance.

Sincerely,

Ted Parsons
General Manager
ATE Inc

TP/cj

AVC
AVC HEARING AID CENTER, INC.
FULTON PLAZA
33 FULTON STREET
MIDDLETOWN, NEW YORK 10940
TELEPHONE (914) 342-5636

PETER A. MECI
CERTIFIED HEARING AID SPECIALIST

BETTE LEE MECI
PRESIDENT

REGISTERED HEARING AID DISPENSER
N.Y.S. DEPT. OF STATE
PENNA. DEPT. OF HEALTH

April 11, 1988

The Honorable J.J. Pickle (D-TX)
Chairman of the House Ways and Means
 Oversight Subcommittee

Dear Sir:

Regarding The reform of The Unrelated Buisness Income Tax. I would like to commend the Sub Committee for proposing an excellent package of reform measures. We would like to see the UBIT applied to all non profits on sales of hearing aids.

We also encourage the Subcommittee to repeal the existing "convenience" exemption for patients or recognize as inpatients only.

We wish to commend you and your committee for undertaking this very difficult problem.

Yours sincerely,

Peter A. Meci

blm/PAM

Peter A. Meci

OFFICES AT:
Newburgh 562-8311
Poughkeepsie 471-1166

Members of:
Capitol District
 Hearing Aid Society
New York State
 Hearing Aid Society
National Hearing Aid
 Society

The Baltimore Museum of Art
Art Museum Drive
Baltimore, Maryland 21218

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

On behalf of The Baltimore Museum of Art, I would like to comment on the preliminary discussion options proposed by the Subcommittee on Oversight, Committee on Ways and Means, regarding the unrelated business income tax.

I. "Substantially related" test

The Baltimore Museum of Art urges the Subcommittee to retain the "substantially related" test in determining whether museum income-producing activities are taxable. This has been an equitable yardstick for non-profit organizations generally, and is particularly important for museum shops.

The Museum has 325,000 visitors a year, many of whom regard the Museum Shop not only as an amenity but as a vital resource. These visitors range from students and scholars looking for books and slides that will assist them in their work to schoolchildren who want to purchase a postcard as a reminder of their visit.

The emphasis in the Museum Shop of The Baltimore Museum of Art is on the display and sale of art books, high quality reproductions, post cards, and art-related items appropriate for collectors and gifts. Materials for children are included that stimulate the appreciation of line, form and color for this important segment of our constituency. For each major changing exhibition, art-related items are included that are in keeping with the theme and period of art history involved.

In regard to a non-profit institution's gift shop/bookstore income, section I A (2) proposes the exemption from tax of only "on-premise sales of an educational nature which relate to the organization visited": A strict interpretation of this section would be disastrous to our educational service to the community. Our Museum Shop is widely known for its comprehensive selection of art books which cannot be readily obtained elsewhere in the state. Although many books, catalogues and reproductions focus on the Museum's collections and exhibitions, a broad range of publications and reproductions from other sources and of a more general nature are provided to serve as a rich background for art education and appreciation. The impositon of UBIT on such sales would severely restrict the overall effectiveness of the Museum as an educational and cultural resource.

Section I L proposes the application of UBIT to "additional specified activities determined to be inherently commercial". This section appears to be unnecessarily broad and subject to interpretation. What specified activities? Who determines? Non-profit institutions must plan carefully to operate within a balanced budget, and the uncertainty resulting from this catch-all phrase is a detriment to such planning. We recommend that this option be deleted.

II. Convenience Exception

The Baltimore Museum of Art has a membership of about 9,600 families who actively enjoy the opportunities offered by the Museum. Although our income-producing activities for members are generally related to the Museum's exempt purpose, we believe that the repeal of the convenience exception would be counter-productive. Members are, in the best sense, the Museum family, providing the base for much of the Museum's contributed income. Since this is so, the recruitment and retention of members requires many programs for their benefit, and the resultant income should be exempt.

Another factor to be considered is the probability that a more restrictive interpretation of UBIT would have an effect on state tax policies which would further constrain the activities of non-profit institutions in carrying out their mission.

We congratulate the Subcommittee on its thorough examination of the possible adverse effect of any change in the tax regulations on the effectiveness and stability of the nation's vital non-profit institutions. With the administration's mandate for shifting responsibility for support of our cultural and educational institutions to the states and to the private sector, it seems only fair to maintain these institutions as free as possible from federal tax.

Sincerely,

Ann Allston Boyce
Deputy Director for Administration

22618 Shorewood
St. Clair Shores, Mi 48081
(B) 1 313 773-3300

TO: Robert J. Leonard
Chief Council for
The Commission on Ways and Means
U.S. House of Representatives

FROM: Georgean A. Barden

DATE: April 13, 1988

SUBJECT: Unrelated Busienss Income Tax Reform (U.B.I.T.) - Oversight Committee of the House Ways and Means Committee

It has been brought tomy attention that the Oversight Committee of the House Ways and Means Committee is involved in the reform of the Unrelated Business Income Tax as itapplies to non-profit entities. (Business)

I commend the Oversight Committee on their efforts and deliberations in this reform.

I am an owner of a SMALL FOR PROFIT HEARING AID BUSINESS in the State of Michigan. Iam writing to you as a Small Business entity.

I urge you to include in your reform of U.B. I.T. hearing aids and related product sales by non-profit Universities, Colleges, Hospitals, Clinics. I urge you to consider taxation of these activities.

Because:

A.
1. A hearing aid is a product.
2. A hearing aid battery is a product
3. A hearing aid repair is a service
4. An ear mold is a product.

All of the above are products which are sold by for-profit business in addition tothe non-profit entities listed above.

None of the products are a requirement (the sale of) for graduation from a college or university, to my knowledge.

None of the products are medicinal in nature such as medicine, bandages, etc., used by hospitals and clinics.

Although a hearing aid is considered a medical device under the F. T.C. rules, our business in Michigan is considered a commercial enterprise by the Dept. of Licensing and Regulation. We are required to be licensed, pass examinations etc., to sell or fit hearing aids in the State of Michigan.

It can only be deduced that the above products are in fact a profit making sale-orientated venture, and even though an entity enjoys a non-profit unbrella status non-profit status should not be allowed for products that the non-profit entity sells unless the product is directly related to the reason the entity is operating.

B. Some colleges and universities who are owned and operated in many instances by the State in which they operate have and are "selling hearing aids/ related products and services.

1. Books as they are required for study are bon-a-fide non profit sales for a University or College as are food, which is often provided due to heavy scheduling and the lack of time for the student to secure meals off campus.

2. Hearing Testing as it is done in manyof the colleges, universities and clinics operated by the college and or university can be considered a necessity under the student curriculm. However, when the testing is done by an Audiologist, M.A. (a person who has received a Master Degree and who is acknowledged by training to be proficient in the testing of human hearing by means of an audiometer and other subjective and testing), who receives a salary/commission from the college/university for performing these duties (many times in addition to overseeing students do these tests, as part of their curriculum and performing teaching tasks for the college/ university)this can not be considered a non-profit activity under the umbrella. To my knowledge all of the patients are charged a fee either self (patient) pay or third party pay. This is an income producing venture forthe non-profit entity.

3. Sale of hearing aid/related products and services: This is also done at the college, university, clinic level. The Audiologist M.A. (usually also required to obtain a Certificate of Clinical Competence from their professional organization) does the testing, diagnoses the loss, prescribes a hearing aid, orders the hearing aid and fits the hearing aid- consumation ofsale. To my knowledge no curriculum of any college or univesity requires that an Audiology student be proficient in Sales. As a matter of fact up until a few years ago when universities/ colleges and some Audiologists went into profit private business the audiological professional organization did not allow their members to "sell hearing aids" as it was unprofessional...Funny what a "few profit dollars" will do, isn't it especially if the "few profit dollars" are tax free!

4. Colleges and Universities do not have as captured a market as hospitals and clinics do, however, physicians who are affiliated with these entities do refer patients for testing as they need these tests in some of their diagnosis. Not all hearing loss's can be helped by amplification, some respond to medical treatment. This diagnosis rightfully belongs to the patients physician., however if the audiologist recommends amplification (a hearing aid), the same audiologist orders and fits the hearing aid- consumation of a "captured market sale", which is non-profit **UNDER THE COLLEGE UNIVERSITY**

non-profit umbrella?

5. Clinics, Hospitals do have a captured market. The hospital or clinic, often has an Audiology Department fully staffed. The physician who is on staff or private practice and affiliated with the clinic or hospital refers patients to the facility for hearing testing to arrive at a diagnosis...if the audiologist recommends to the doctor that the patient will benefit from a hearing aid, that audiologist if he is licensed to sell hearing aids (if the State requires it) orders the aid, fits it and thereby completes a "captured market sale" often at the same price as the profit market business and the "profit" is considered non-profit under the Clinic, Hospital non-profit umbrella.(in many states in order to get around the licensing law requirement of licensing to sell or orfit hearing aids the audiologist will have the patient make out a check to the supplier of the hearing aidfor the cost of the hearing aid and a separate check tothe clinic or hospital for testing and fitting fees) - when this is done the facility then feels that there has been "no sale" of the hearing aid as far as they are concerned--they were just paid for testing and fitting (dispensing) which they consider a service, which they consider a proper non-profit activity.
In my opinion... I better not give my opinion!
These same entities, sell batteries, sell ear molds, and do repairs on hearing aids. I cannot understand how any non-profit entity can consider these products non-profit (non-income producing)!

C. 1. My business is hurt by the non-profit entity who uses in many instances TAX DOLLARS, which a percentage of which I have paid thru my profit making small business to purchase equipment, pay salaries, ADVERTISE and then use the Profit to fund other unsuccessful bonafide non profit activities in their "non-profit business". My small business cannot hope to compete with a non-profit entity as more an more of the non-profit entities of this kind enter the business of selling and fitting hearing aids.

If my business (which by the way is flurishing) cannot hope to compete, what happens to other like-kind small business in my State.

Scenerio: If profit hearing aid business fails because non-profit-captured market entities enter it and they do not pay any business taxes and I don't either because I'm not in business any more... how are we going to fund the much needed programs... and really the non-profit will be out of business eventually too as the TAXES which I and others like me will not be forthcoming and the non-profit entity will lose its "investor" which is really the taxpayer! and, and, and!

2. My commissioned salespersons and my salaried clerks, will be out of work-- adding to the unemployed. They will not be paying taxes and some may also be an addition to the already overburdened public assistance.

3. Believe me when I say, Small Business is hurting from unfair competiton by non-profit tax-exempt entities.

D. The problem has reached serious proportions:

1. In 1987, the President's Conference on Small Business was held in Washington, D. C. The Number One priority tocome out of that conference:

   Government organizations and non-profit, tax-exempt entities should be prohibited from using their financial and promotional advantages tosell products and services in direct competition with tax paying small business.

   This conference covered all types of small business, not just mine.

2. February 26,27, 1988, the Michigan Governors Conference on Small Business convened. The Number One priority--you guessed it; same as above!

E. Something is being done but is it enough?

1. In May of 1986 an article appeared in one of the many publications:

" Tax-exempt organizations may owe income taxes on at least part of their revenuse from selling advertisements in their publications, the U.S. Supreme Court has ruled unanimously. The decision involved the American College of Physicians receipts from drug ads placed in its Annals of Internal Medicine but could affect a variety of tax-exempt groups that publish magazines or journals".

Imagine what that would do for me, if I could publish an ad like that in a book on medicine. Don't you think that the people reading it would think that I was endorsed by the physicians?

In conclusion: I urge you to use whatever resources are available to your committee, toread letters and solicit letters and comments from small business constituents, to enable the committe to come to a fair and equitable decision. I urge you to apply U.B. I.T, toall hearing aid sales income of non-profit/tax-exempt entities.

Thank you for taking my comments under consideration.

THE FOLLOWING NON-PROFIT, TAX-EXEMPT ENTITES ARE MY COMPETITION

HENRY FORD HOSPITAL... Private/Non-profit

UNIVERSITY OF MICHIGAN -University-owned -Non-Profit

William Beaumont Hospital- Private/Non-Profit

Harper Hospital- Private/Non-Profit

Sinai Hospital of Detroit Private/Non-Profit

Oakwood Hospital Private/Non-Profit

Owkwood Hospital Private/Non-Profit

Providence Hospital Catholic/Non-Profit

St. Joseph Mercy Hospital Catholic/Non-Profit

Wyandotte General Hospital City Owned/Non-Profit

Wayne State University- Rehabilitation Center- State Owned/Non Profit

Detroit Speech & Hearing Center Non-Profit

Pontiac General KennyMichigan rehab- Non Profit

BCMW COMMUNITY SERVICES, INC.
SERVING BOND, CLINTON, MARION & WASHINGTON COUNTIES
909 EAST REXFORD P. O. BOX 729
CENTRALIA, ILLINOIS 62801
Phone 532-7388

April 13, 1988

Chairman
Doris Clark

Executive Director
Russell Rose

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House - Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

BCMW Community Services, Inc. is a not-for-profit Community Action Agency in the great state of Illinois. We operate approximately eight (8) Federally and State funded programs. During the last decade, we have absorbed the cost of funding cuts and reductions by leveraging local dollars to maintain previous service levels.

Our agency has received financial support from cities and county governments in the past. Something the majority can no longer afford.

As sources of funding in the public sector dry up, we find it even more imperative to engage ourselves in fund raising activities to carry out our mission statement.

I'd like to site several examples of some of the types of activities and their related purposes. Department of Aging programs require a 20% cash match on all of their program activities. We sponsor cultural events within the communities to raise these funds. Health and Human Services (Head Start) requires parent involvement in all forms. These parents sponsor cookie sales, bake sales and sales of other consumable items to support field trips, nature hikes and to purchase Christmas presents for these under-privileged kids.

Beyond that, the Department of Commerce and Community Affairs, by legislative mandate, requires that we set aside 15% of our Community Service Block Grant Program funds for a Revolving Loan Program. The funds are used for Small Business expansion or start-up, which provides employment for low-income individuals and derives the agency interest on the repaid principal.

We feel that restructuring the I.R.S. Code relative to unrelated business income would be detrimental to the recipients of our services.

Please reconsider this restructuring.

Sincerely yours,

Russell Rose
Russell Rose, Executive Director
BCMW Community Services, Inc.

Doris Clark
Doris Clark, Board Chairman
BCMW Community Services, Inc.

RR/DC/kg

Beltone Audio Services
2701 Belair Road
Fallston, Maryland 21047

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

April 12, 1988

To Whom it may concern:

I would like to express my commendation to the House Ways and Means Oversight Subcommittee and in particular to the Honorable J. J. Pickle, chairman, for proposing an excellent package of reform measures in reference to the commercial hearing aid sales by non-profit organizations.

I urge the Subcommittee to include all these measures in its final report. In addition, I also urge the Subcommittee to apply the Unrelated Business Income tax system to apply to all hearing aid sales income of nonprofits. I feel that such sales inherently are of a commercial nature. I am well aware of the competition that these sales pose to the small business owners. I would encourage the Subcommittee to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

I feel that we, as independent small business owners, must keep up our efforts against unfair competition from nonprofits.

Thank you.

Thomas A. Fisher

Beltone®
Better Hearing Through Professional Care

Beltone Hearing Aid Centers

Main Office
1248 Main Street
Longmont, CO 80501
Telephone:
776-8748
Metro Line:
440-4417

Boulder Office
2885 E. Aurora Ave., #14
Boulder, CO 80302
Telephone:
443-1773

Ft. Collins Office
Clifton Professional Bldg.
151 W. Oak, #11
Ft. Collins, CO 80524
Telephone:
221-5011

In Colorado call:
1-800-548-HEAR

April 11, 1988

Hon. J. J. Pickle
242 Cannon House Bldg.
Washington, D. C. 20515

Dear Mr. Pickle,

I am a Hearing Aid Specialist from Colorado and I am writing you about a hearing held by the Oversight Subcommittee of the House Ways and Means Committee on the Unrelated Business Income Tax held in June of 1987. Because you are a member of this committee, I urge you to help me in getting recommendation out of the sub-committee so that further action can be taken.

I want to commend the sub-committee for proposing an excellent package of reform measures and encourage you to include all of these measures in your final report. I would especially encourage you to apply UBIT to all hearing aid sales income of non-profits.

I ask you repeal the existing "convenience" exemption for patients or recognize them as inpatients only.

The extent to which non-profits are invading the commercial realm is quite problematic and effects my very livelihood and I solicit your assistance.

Sincerely,

James Boggess

James Boggess
Certified Hearing Aid Audiologist

JB:la

James W. Boggess, Jr., Certified Hearing Aid Audiologist
Katherine M. Boggess, Hearing Aid Specialist
Authorized Beltone Sales & Service Centers, Specialists in Scientific Fitting & Servicing of Hearing Systems.

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801 S. Washington
935-2591

BELTONE OF CENTER
321 Shelbyville
598-5305

BELTONE OF HENDERSON
1609 Hwy. 79 South
657-2116

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C., 20515

Dear Sir;

I urge you to support the recommendations regarding reform of the unrelated business income tax (UBIT) system that applies to non-profit organizations. Especially the options concerning commercial hearing aid sales by non-profit organizations.

Sincerely,

John R. Czop A.C.A.
Audioprosthologist

**BELTONE
HEARING AID
CENTER**

**AUTHORIZED BELTONE
HEARING AID DISPENSER**

**3277 AUSTIN PEAY HWY.
(DIRECTLY ACROSS FROM
K-MART IN RALEIGH
SPRINGS MALL AREA)
MEMPHIS, TN 38128
TELEPHONE: 372-2800**

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April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Sir:

I want to first congratulate the committee for addressing the subject of unfair competition from tax supported-tax free institutions who are directly competing in hearing aid sales with the small business owners who are paying taxes to support this type of competition.

Here in the City of Memphis we have Memphis Speech & Hearing Center who test and recommend mail order hearing aids from out of the State so they can compete with private enterprise. Another here in Memphis is the University of Tenn. who test and fit hearing aids at a much lower cost. This same thing is happening at Bill Wilkerson Speech and Hearing Center in Nashville, Tenn.

The University of Mississippi at Oxford, Miss. also dispenses hearing aids in competition with private small business enterprises.

Another different area of competition is from Ear Doctors who have a captive market and are fitting hearing aids.

A law passed effective August 15, 1977, Food & Drug Administration, Dept. of Health, Education & Welfare
Sub-Chapter H Medical Devices
Docket No. 76N-0019
Federal Register Vol. 42 No. 31 Tuesday, Feb. 13, 1977.

The law states prospective purchasers and anyone under the age of 18 has to be sent to a Ear Specialist to get a medical clearance. It is getting so that there are so many doctors dispensing that you can't send them to just any Ear doctor for medical clearance because they will fit them with hearing aids in their own office by someone that works for them. This law made them competitors immediately without any additional overhead on their part.

This FDA law has enabled Ear Specialists to sell hearing aids to their patients and patients we refer to them for medical clearance. This has happened here many times.

Sincerely,

K. Johnny Elias

K. Johnny Elias

(Identical letter received from James A. Cochran)

April 13, 1988

BELTONE HEARING AID SERVICE
2150 Washtenaw
Ypsilanti, Michigan 48197

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chief Counsel Leonard:

The commercial hearing aid sales by nonprofit organizations is having a costly effect on my business in Washtenaw and Jackson counties in Michigan. This unfair competition has also had a demoralizing effect on those employed by me who are engaged in the scientific fitting and sale of hearing aids.

Specifically in this area: Jackson Speech and Hearing Clinic and McCauley Health Center in Ann Arbor continue to employ the "mail order" dealer system, while never mentioning the unbundled costs to patients until services are initiated.

I strongly and enthusiastically commend the committee for proposing an excellent package of reform measures.

Being in direct competition with a nonprofit organization while having to pay payroll taxes, unemployment taxes, Michigan SBT taxes etc. is grossly unjust.

The Subcommittee should also work hard to repeal the "convenience" exemption for patients or at least recognize patients as inpatients only. After all, once a person receives a hearing aid..........Are they any longer a patient??

My thanks to the Subcommittee for their time, efforts and future considerations for the small businessman. Those engaged in hearing aid sales facing the unfair competition of the nonprofit organization need your support.

A Grateful Small Businessman,

Roland R. Erno
Michigan State License
#000356

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CARL E. McCURDY, AUTHORIZED BELTONE DEALER

SPECIALISTS IN SCIENTIFIC FITTING AND SERVICING OF HEARING AIDS

BELTONE HEARING AID CENTERS
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(703) 343-5567
SALEM
26 W. MAIN STREET, 24153-3802
(703) 389-8700
LYNCHBURG
FORT HILL VILLAGE SHOPPING CENTER, 24502-1931
(804) 237-6294
MARTINSVILLE
218 E. MAIN STREET, 24112-2816
(703) 632-7725
CHARLOTTESVILLE
1936 ARLINGTON BOULEVARD, 22903-1559
(804) 977-2770

April 13, 1988

The Honorable J.J. Pickle
Chairman of the House Ways and Means
Oversight Subcommittee

Dear Sir:

I am writing this letter to congratulate the House Ways and Means Oversight Subcommittee regarding the options that they have suggested in regard to the reform of the Unrelated Business Income Tax system. I fully support the Subcommittee in all their reform measures. I am especially concerned about the options which deal with the commercial hearing aid sales by non-profit organizations.

The non-profit organizations, I believe, should not fit or sell hearing aids to anyone, because anyone they fit with hearing aids can be called their patient or inpatients. There should be no acceptable reason for the non-profit to sell hearing aids when there are several small hearing aid businesses in the same area that can take care of these people. These small businesses do contribute to the tax base which non-profit organizations do not.

Why should the non-profit organizations hide behind tax exempt status to sell hearing aids - when they are making a profit from these sales?

Most non-profit organizations receive donations each year from the United Fund and other organizations. Why should small business men have to compete with non-profit organizations who receive donations and are tax exempt?

Why should small business men work and pay taxes in order to help non-profit organizations to sell hearing aids cheaper in direct competition with them?

Please continue with your good work.

Very truly yours,
Dennis F. Farnsworth
Dennis F. Farnsworth
Hearing Aid Specialist
Beltone Hearing Aid Center
Fort Hill Village Shopping Center
Lynchburg, Virginia 24502

ERVIN E. KING, OWNER
BELTONE HEARING AID CENTER
1300 Avenue C, Suite 1320
Billings, MT 59102

April 14, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Subcommittee on Oversight
Discussion Options Relating to
the Unrelated Business Income Tax

Dear Sir:

In opening, may I applaud the Subcommittee's insight into the problem of non-profit organizations competing unfairly in the marketplace. The proposals under consideration are all very good means of addressing existing unfairness and are all very much needed.

Of particular importance to me, of course, is the discussion option applying to sales of medical equipment, especially hearing aids.

We are locally faced with the Easter Seals organization, which has been using every means at its disposal to aggressively compete against the private sector. Costly advertising campaigns, far exceeding anything those of us in private practice could afford, are being carried on continuously. This advertising uses Easter Seals' government-allowed advantages as selling points, i.e.: a) that their products can be sold at less cost to the consumer. (With no tax, reduced operating costs, contributions, etc., I should hope so!)

b) that by being a charitable organization the client's interests are better served (the so-called "halo effect") when, in fact, their staff is often changing and is no better qualified (often less) than the private sector's.

c) that only the client's interests are served. (Easter Seals implies it is not interested in making money, but in fact, that is the ONLY reason for its being in a dispensing program.)

I urge the Subcommittee to continue its good work, and to make its final recommendations to the Committee with all the proposed reform measures in tact. If restrictions on non-profit organizations are not initiated soon, that which is already a big problem within the small business community, will continue to grow and invade every sector of business, eventually threatening our entire free enterprise system.

Yours very respectfully,

Ervin E. King

Ervin F. King

BELTONE HEARING AID SERVICE

ANNA F. LEWIS
AUTHORIZED BELTONE
HEARING AID DISPENSER

P.O. BOX 1152
1900 SHERWOOD WAY
SAN ANGELO, TX 76902
TELEPHONE: 944-4543

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April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am the owner of a small hearing aid business that serves the hearing impaired in San Angelo, Texas and several surrounding counties.

In the past few years, this non-profit status of a local dispensary has affected my business and the production of my employees. There are few weeks that one or more do not report that West Texas Rehabilitation, or some other non-profit, has fit someone they have previously tested and evaluated. The reason they got them cheaper (which is just about the amount of commission they would receive) is because there is no commission or overhead involved. So, not only does it effect the business itself, it also effects many other hearing aid dispensers in the area.

There are some of the persons I have been serving for many years that have now been refit by the West Texas Rehabilitation and other non-profit establishments. The reason being they can get them cheaper - but they still have to pay much more than cost, plus they have donations from the general public to help with the overhead (which I do not).

In addition to the prior wearers, I loose other prospective clients as the advertising they are able to afford (that I cannot) gives them an advantage so that most people know of the price break. The price break still leaves them with a profit.

I, therefore, ask you to help by supporting the Unrelated Business Income Tax as I do not think it is fair for me and others to help support our competitors as this is what we are doing through tax breaks and donations to charity-type funds; they get a portion of many.

I am not totally against the West Texas Rehabilitation and others, but I do think that those able to afford the service should not be allowed to use them. They do not check the financial ability of the patient to pay for services, etc., however, they do apply for insurance on those that have it, therefore, they are not a non-profit as they claim.

Please support a change so that unfair competition to the small businesses is eliminated.

Thank you,

Anna F. Lewis, B.C., A.C.A.
Audioprosthologist

cc: The Honorable J.J. Pickle

SCIENTIFIC FITTING AND SERVICING OF HEARING AIDS • LICENSED BY THE STATE OF MICHIGAN

Beltone HEARING AID CENTER
AUTHORIZED DEALER FOR THE NEW BELTONE

723 EAST EIGHTH ST.
TRAVERSE CITY, MICH. 49684
TELEPHONE 616—947-4960

WILLIAM SHOLTEN - DEALER

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

I am writing to strongly urge you to apply the Unrelated Business Income Tax system to tax-exempt organizations which are in direct, commercial competition with tax-paying enterprises.

We are a small, tax-paying for profit business engaged in the testing of human hearing and the fitting of appropriate amplification, and have been in operation for 25 years in this area. We find that we are in increasing competition with Munson Medical Center's Speech and Hearing Department, a "non-profit" organization here in Travese City. Munson Medical Center has adopted standard commercial practices to sell hearing aids to the general public. Our modest local advertising triggers direct, large-scale and derogatory counter-advertising from Munson, which by implication attacks our competancy, ethics, and pricing structure. We do not object to the competition itself, but to the unfair nature of the competition. As a "non-profit", Munson benefits not only from the tremendous financial resources of the parent organization, the "halo effect" generated by their affiliation with a large medical center, the substantial savings in mailing rates and in non-payment of state and local taxes, but also from its position as a recipient of grant monies and tax-deductable donations. We find it ironic indeed that the taxes which we pay go to support the activities of our largest and most powerful competitor.

We feel that competition among equals can only serve to improve the standards of service offered to the hard-of-hearing public, but that unfair competition from tax-exempts which may actually drive some independent businesses out of business can only result in a lessening of the quality of services available to hearing impaired persons.

Please take steps to resolve this inequity. Support the application of the UBIT system, repeal the "convenience" exemption for patients, support the tax-payers, rather than the tax-exempts.

Thank you.

Most Sincerely,

Karen S. Maas
Certified Hearing Aid Audiologist

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OGUREK
ENTERPRISES, INC.
BELTONE
HEARING AID
CENTER

AUTHORIZED BELTONE DEALER

209 JEFFERSON STREET
WAUSAU, WI 54401
TELEPHONE: 715/842-9882

April 14th 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

In 1987, the House Ways and Means Overright Committee met to discuss the impact of "nonprofit" organizations competition on for-profit private businesses. As a private businessman, in the retail hearing aid business, I would first like to commend the Subcommittee's final Unrelated Business Income Tax recommendations. These measures effectively resolve the problems of unfair competion resulting from "nonprofit" organizations. It is vital, however, that two provisions be included in the final report.

> First, that the Unrelated Business Income Tax apply to all hearing aid sales income by nonprofit organizations, and secondly, that the Subcommittee repeal the existing "convenience" exemption or recognize patients as inpatients only.

The implementation of the Subcommittee recommendations, including these two provisions, will result in a market place in which unbiased competition can occur and this will insure that the markets operate efficiently. Thank you for your time.

Sincerely,

James Ogurek

James Ogurek
Owner Beltone Hearing Aid Center
209 Jefferson St.
Wausau, WI
54401

JAMES OGUREK • DEALER • HEARING AID SPECIALIST • STATE LICENSE NO. [illegible]

SPECIALISTS IN SCIENTIFIC FITTING AND SERVICING OF HEARING AIDS

April 13, 1988

BELTONE HEARING AID SERVICE
822 North Wisner
Jackson, Michigan 49202

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Reprisentatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chief Counsel Leonard:

With the tax break advantage, nonprofits can sell so much cheaper which eliminates an environment that calls for "Fair Trade".

I feel that if nonprofit business is allowed in the hearing aid field; then why not other fields? How about nonprofit car dealerships, clothing stores or nonprofit airlines?

Unrelated Business Income Tax should apply to all hearing aid sales income of nonprofits.

Sincerely,

Lawrence J. Ritter

Lawrence Ritter
Michigan State License
#001596

April 13, 1988

BELTONE HEARING AID SERVICE
2150 Washtenaw
Ypsilanti, Michigan 48197

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chief Counsel Leonard:

As a certified Audiologist in the hearing aid business, (private sector) I strongly recommend reform of the Unrelated Business Income Tax system that applies to nonprofit organizations.

Having spent countless hours of college training in the nonprofit audiology clinic, I know full well their goal is to put the hearing aid dealer out of business based on deceptive advertising and offers of low priced hearing aids. What they do not tell the people until they get there, is they have to pay very high prices for all testing. I have enclosed a sample of this as applies to our area.

By the time all is said and done, the hearing aid costs the same as the private sector, with the exception that the clinic only allows one year of free service versus the life of the aid.

Not only is this deceptive, but being in direct competition with a nonprofit clinic is an unfair disadvantage to our organization. Nonprofits should have to pay the same for stamps, advertising and any other thing they are exempt on. I hate the thought of my tax dollars supporting that type of practice in direct competition to me. The nonprofit status should be stopped and stopped now!

If you need any further information, I would be happy to provide it to you.

Sincerely,

K. Roger Smith

K. Roger Smith, MA CCCA
Michigan State License
#001083

attachment enclosed

"HEARING AID POLICY AND FEE SCHEDULE"

[redacted] Audiology Services, located in the [redacted] Health Building, Suite 2016, is staffed by certified audiologists with graduate training in audiology. Our hearing aid services were initiated in order to provide a professional evaluation of each patient's ability to benefit from a hearing aid, and to offer a comprehensive rehabilitative service to insure that each patient fitted with a hearing aid becomes a successful hearing aid user.

The procedures and fees for obtaining a hearing aid are as follows:

1. A HEARING TEST is conducted by the audiologist within six months preceeding the hearing aid evaluation to determine the degree and type of hearing loss.

$48.00 - 68.00

1. Medical clearance for a hearing aid is recommended. This can be obtained from your family physician or an ear, nose, and throat (ENT) physician. If you have insurance that covers hearing aid services, you may be required to see an ENT physician.

ASK FOR → 3. A HEARING AID EVALUATION is conducted by the audiologist to determine whether or not a hearing aid would be beneficial and which hearing aid should be ordered.

$75.00

4. Following the hearing aid evaluation (same day), an impression is made of your ear and an order is made out to the HEARING AID CENTER OF KALAMAZOO for the hearing aid that has been recommended. Payment in full for the hearing aid must be enclosed with the order (check, money order, Master Card, Visa, or American Express).

Approx. $250.00

5. When the hearing aid is received by Audiology Services (3-4 weeks after the order is placed), you are informed by mail and asked to call for an appointment to pick up your hearing aid.

6. At the HEARING AID FITTING appointment, you receive your hearing aid and instructions regarding its use and care. The audiologist also tests you with your hearing aid to insure that you are receiving the maximum benefit from amplification.

$200.00

7. With any hearing aid purchased through Audiology Services, you receive a THIRTY-DAY TRIAL PERIOD to insure that you are satisfied with your hearing aid. If you are not satisfied, a different hearing aid can be ordered, or you can be refunded the costs of the hearing aid from the Hearing Aid Center of Kalamazoo and the $200.00 Hearing Aid Fitting fee. The $75.00 Hearing Aid Evaluation fee is non-refundable.

NO CHARGE

8. Typically, you should return for a HEARING AID CHECK appointment during the thirty-day trial period to ask questions and raise any concerns you may have regarding your hearing aid.

NO CHARGE

9. You receive TWELVE MONTHS OF OFFICE VISITS to handle any additional problems you may have with your hearing aid.

NO CHARGE

10. You receive a ONE YEAR WARRANTY on repairs for your hearing aid. You are responsible for a $3.00 handling fee to the Hearing Aid Center of Kalamazoo.

SUMMARY OF COSTS

Hearing Test	$48.00-$68.00
Hearing Aid Evaluation	$75.00
Hearing Aid	approx. $250.00
Hearing Aid Fitting	$200.00
Estimated Total	$580.00

**BELTONE
HEARING AID
CENTER**

AUTHORIZED BELTONE
HEARING AID DISPENSER
1345
[illegible] 8TH ST. SO.
WISCONSIN RAPIDS, WI. 54494
TELEPHONE (715) 423-1815

Beltone
Better Hearing Through Professional Care

April 11, 1988

The Honorable J.J. Pickle:

As a small business man I would like to commend the UBIT Subcommittee for proposing an excellent package of reform measures, and would very much encourage the Subcommittee to include all these measures in their final report.

I would like to take this opportunity to stress my displeasure with the so called nonprofit organization called Marshfield Hospital and Clinic in my area. This organization also has it's own health insurance program, known as The Greater Marshfield Plan, which many of the people in approximately a 75 mile radius have. The way it works is the elderly people get their hearing tested, and if they have the Marshfield Plan the Doctor and the Audiologist are paid through the insurance for the test. The customer then receives a free thirty day trial period on the aids, because the Doctor and Audiologist get paid by the insurance and have nothing to lose. After the trial period the customer can then purchase the aid or aids, for approximately 30 to 35% less than they can from a Hearing Aid Dealer like myself, because of their nonprofit status. I realize the insurance issue is not your concern, but I felt it should be brought up because it works with the nonprofit status.

I also realize that a small business like my wife and I have is very important to this community, state and country. I don't mind the competition selling their products cheaper if they must abide by the same tax laws I have to go by. Therefore I urge you to apply Hearing Aid sales to sales income for nonprofits.

P.S. The Marshfield Clinic doesn't pay property tax and just announced an 18 million dollar addition.

Sincerely,
Olin Stenbroten
Olin Stenbroten
Beltone Hearing Aid Center
1345 8th St. So.
Wisconsin Rapids, Wi 54494

OLIN STENBROTEN • CERTIFIED HEARING AID AUDIOLOGIST

SPECIALISTS IN SCIENTIFIC FITTING AND SERVICING OF HEARING SYSTEMS

Beltone
WHEN A HEARING
AID WILL HELP

ELLIS J. THOMAS, III, AUTHORIZED BELTONE DEALER

SPECIALISTS IN SCIENTIFIC FITTING AND SERVICING OF HEARING AIDS

BELTONE HEARING AID CENTER

1722 ASHLEY RIVER ROAD
CHARLESTON, SOUTH CAROLINA 29407
TELEPHONE (803) 766-0871

April 12, 1988
Tuesday

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth, House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard,

I would like to express my concern for the commercial Hearing Aid Sales by Non-profit organizations.

We pay taxes to support the Speech and Hearing Centers that are now in direct competition with the private sector.

I dropped out of the "Sertoma" Club that was dedicated to helping indigent people with speech and hearing & other disabilities because we donated money to the Speech and Hearing Centers that started "selling" hearing aids for a profit. The problem is nationwide and I hope the government will stop this practice by non-profits competing with the business for profit.

I would enjoy having a salary by the State & Federal Government then dispensing hearing aids as "Icing on the cake".

Please help stop the "commercial selling" of hearing aids by non-profit organizations such as Speech and Hearing Centers and Universities.

Sincerely Yours,

Ellis J. Thomas

Ellis J. Thomas, III
Hearing Aid Specialist

cc: National Hearing Aid Society
Sen. Strom Thurmond
Sen. Arthur Ravenel

Beltone
WHEN A HEARING
AID WILL HELP

BELTONE
HEARING AID
SERVICE

AUTHORIZED BELTONE DEALER

1301 MAIN STREET
PASADENA, TEXAS 77506
TELEPHONE: 477-4835

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 longworth House Office Building
Washington, D.C. 20515

Dear Sir,

It has come to my attention that public comment has been requested concerning some options that affect the Unrelated Business Income Tax (UBIT).

My specific concern is the commercial sales of hearing aids by non-profit organizations. Since they are tax exempt and often even subsidized it places an unfair competetive situation between us and siphons away potential customers. This affects my income and your tax base.

We would encourage that you apply UBIT to all hearing aid sales of non profit organizations. We also encourage that exemptions be eliminated.

Thank you for your consideration.

Sincerely,

Holly Underwood
Hollis Underwood
Audioprosthologist A.C.A.

HOLLIS UNDERWOOD
Audioprosthologist • Member National Hearing Aid Society • Member Texas Hearing Aid Association
Member of American Tinitus Association • Member of American Conference of Audioprosthology

SPECIALISTS IN SCIENTIFIC FITTING AND SERVICING OF HEARING AIDS

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Better Hearing Through Professional Care

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AUTHORIZED BELTONE DEALER

Serving The Following Counties:
MANATEE
SARASOTA
CHARLOTTE
HARDEE
DE SOTO

April 11, 1988

The Honorable J.J. Pickle, Chairman
Robert J. Leonard , Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Re: Unrelated Business Income Tax (UBIT) System

The Honorable J.J. Pickle:

I commend the Subcommittee for proposing an excellent package of reform measures.

I wish to encourage the Subcommittee to include all these measures in its final report, and especially to apply UBIT to all hearing aid sales income of nonprofits.

I stress the inherent commercial nature of these sales. I encourage the Subcommittee to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

Non-profit competition has had a definite effect on my business in Manatee County. Beltone has been serving the needs of the hearing impaired in Manatee County for over 25 years.

Sincerely,

Douglas R. Wagner

Douglas R. Wagner
Owner

DRW:mpr

April 13, 1988

BELTONE HEARING AID SERVICE
822 North Wisner
Jackson, Michigan 49202

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chief Counsel Leonard:

I applaud the subcommittee on its measures concerning the Unrelated Business Income Tax system as it applies to nonprofit organizations.

All of the measures in the reform package are of great importance. I urge you to include all in the final report.

The sale of a hearing aid is most definitly of a commercial nature. Anyone involved in commercial sales should be subject to the same taxes and regulations of those involved in private business. The Unrelated Business Income Tax must be applied to all nonprofits, or the private and small businessman will continue to suffer from the unfair competition.

There is a speech and hearing clinic in town which is able to sell an aid for a considerably lower price. When patients find the difference in prices they can't see any reason for the difference, and even when explained, many don't care as long as it's cheaper. Nonprofit organizations should not be allowed to have this kind of advantage.

Again I ask that all measures of this reform be considered and utilized. Unrelated Business Income Tax should be applied to all hearing aid sales income of nonprofits.

Sincerely,

Carol Walczak

Carol Walczak
Michigan State License
#001804

Beltone® HEARING AID CENTER
817 EAST 7TH
ODESSA, TEXAS 79761

PHONE (915) 332-0519
CENTRAL OFFICE

[illegible] WEST WALL
MIDLAND, TEXAS 79701
PHONE (915)[illegible]

[illegible] SOUTH JOHNSON
BIG SPRING, TEXAS 79720
PHONE (915)[illegible]

April 12, 1988

To All Concerned With The Reform Of The Unrelated Business Income Tax (U.B.I.T.) System That Applies To Non-Profit Intities:

The House Ways and Means Oversight Committee is to be commended for proposing an excellent package of reform measures to limit the unfair competition by non-profits. We urge the Subcommittee to include all these measures in their final report.

Please repeal the existing "convenience" exemption for "patients" as inpatients, only.

This would help to eliminate the tax exempt enitites from the present practice of engaging in commercial sales under the guise of "just providing for their patients".

Please apply U.B.I.T. to all hearing aid sales income of non-profit organizations. The Easter Seals funded Permian Basin Rehabilitation Center in Odessa and West Texas Rehabilitation Center in Abilene are in direct competition with our hearing aid offices in West Texas. According to "The Hearing Journal", May 1987 issue, over 76% of Rehab's gross receipts in 1983 was from sales.

Under the "halo" of 'taking care of the poor', Rehabs' are engaged intensely in competing for hearing aid sales. We can document the fact of agressive marketing as well as the fact they have fitted very wealthy people. Our tax dollars are used by Rehabs to engage in keen competition with us unfairly.

Please include all the Subcommitte's excellent package of reform measures. Also, please repeal the existing "convenience" exemption for patients or recognize patients as impatients, only.

Sincerely,

Curt Wallis
Peggy J. Wallis
Mike Wallis
Jimmie L Garrett
Linda Christopher
Josh Villasenor
Karen W. Villasenor

Beltone Hearing Aid Centers
Curt Wallis, Peggy J. Wallis, Mike Wallis, Josh Villasenor, Karen Villasenor, Jimmie Garrett, and Linda Christopher

April 13, 1988

BELTONE HEARING AID SERVICE
2150 Washtenaw
Ypsilanti, Michigan 48197

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chief Counsel Leonard:

The nonprofits are direct and unfair competition to the small businessman. I urge the committee to apply the Unrelated Business Income Tax (UBIT) to all hearing aid sales income of all nonprofit organizations.

The present sales of hearing aids at the very low price they are able to offer is because of their tax free standing. This threatens open market, fair trade competition. In addition, nonprofit organizations do profit from charging in a commercial nature for the necessary related services which are needed in the continuing care of the hearing impaired person.

I recommend you reform the nonprofit status and urge you to include them in your final package.

Sincerely,

Claudia Williams

Claudia Williams
Michigan State License
#001833

BERGWALL
BVP
VIDEO•PRODUCTIONS

1-215-499-7430
1-800-645-3565
P.O. Box 922 • Media, PA 19063-0922

April 14, 1988

Robert J. Leonard
Chief Counsel
COMMITTEE ON WAYS AND MEANS
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

Below are my comments regarding Press Release #16 date March 31, 1988 from J.J. Pickle, Chairman of the Subcommittee on Oversight.

My firm produces instructional video and computer software programs that are sold to the educational market. As a small business that's been consistantly undercut by Universities, Department of Education Consortiums and other non-profit organizations, I'm relieved to finally see some long overdue changes in the IRS rules regarding UBIT.

I am in full agreement with all the Subcommittee's discussion options. I hope they are all implemented. However, I'd like to comment on item I. (L). It states that UBIT should be applied to additional specified activities determined to be inherently commercial. Does the phrase "inherently commercial" mean competitive with the commercial sector? I hope it does. If not, please clarify this item so that UBIT applies to any activity, from a non-profit, that competes with a "for-profit" commercial entity offering the same service or products. In other words, all non-profits should have to pay the same business taxes on revenue it receives for any services or products it offers that compete with the private sector.

Remember, competition is not the problem. Small business thrives on competition. However, competition that has an unfair economic advantage, because of not having to pay business taxes is the problem.

Thank you for your time and consideration.

Sincerely yours,

Bruce Bergwall
President

cc: Richard Schulze
Curt Weldon

BB/lr

BETTER FABRICS TESTING BUREAU, INC.
AN OPERATING DIVISION OF LABTEST USA INC.
101 WEST 31st STREET NEW YORK, N.Y. 10001 (212) 868-7090

April 13, 1988

Mr. Robert L. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Re: Nonprofit Competition

Dear Mr. Leonard:

As a tax paying, independent testing laboratory, we are deeply concerned about the unfair advantage enjoyed by many "nonprofit" organizations that are in effect competing for our business.

We do engage in substantial number of tests related to public safety, i.e. flammability, toxicity, etc., and still pay full tax on our profits. Therefore, tax exemption for testing for the public safety should be deleted, so as to treat all testing firms on an equal basis.

I hope you and your committee will take into account our concerns when preparing your final recommendations.

Very truly yours,

Gabriel A. Falla
President

GAF/bm
cc: Mr. Walter Poggi, ACIL
Mr. Ted Weiss, Congressman

From
BETTER HEARING AID CENTER
Box 497 - 1008-9th Ave.
Greeley, Colorado 80631
Phone 352-0440

4/11/88

For L.H. Vanderhoof

To Robt J Leonard
Committee on Ways + Means
Washington D.C.

I have been a Certified Hearing Aid Audiologist for many years and have a Degree from Colorado State University in Ft Collins Colo. My son Dr. Clark Vanderhoof and I are both honor Alumni and take interest in their activities.

I have been testing for and fitting hearing aids for 27 years in the same location and office. Thus I have had about all the growth years and experience of this new profession. Have given service of fitting many hearing aids to all kinds of people young + old with all of the disorders.

The last ten years has been a rapid growth of many Non Profit units who have intered this profession to take a large percent of the fittings which have been commercial in reality.

The medical Specialists are doing a good job where the patient needs medical advice and attention that Hearing Aids cannot solve.

The non profit organizations have moved in and do not pay taxes, rents, all expenses, buy equipment to operate a testing office, which i quite expensive.

Take me as an example since I have been trying to retire for several years. You should hear the old people who have had their aids serviced by my office. Have been begging & ~~tel~~ pleading not to do it as they have no one to depend on. True old people are not passing away as fast as old are growing in numbers. Free service to the ones who have purchased their aids from the non profits cannot make any profit overall. The last two years I have not had to pay much income tax to our government. That makes two who are not paying tax for our increasing expenses. I am forced to quit this year and can sell for a small amount as don't want to lose what I have saved for my old age.

Now I am listing just a few of the colleges and universities that are close to Greeley Colo. who dispense hearing aids. Univ of Wyoming — Sterling Junior College — Colo. State Univ — Univ. of Northern Colo. at Greeley — Colo. Univ at Boulder — Denver Univ — Pueblo College — Mesa State College — plus all the employees near or working for the above and all school district teachers and employees get lower

BETTER HEARING AID CENTER
Box 497 - 1008-9th Ave.
Greeley, Colorado 80631
Phone 352-0640

price as they are guided to the non profits.

Past years I fitted from these non-profits as the average of several hundred per year. The last three years have fitted few one but they know where my place is located when their aids need repairs and service.

Now I urge You to consider the Unrelated Business Income tax (UBIT) system that applies to non Profit organizations who sell Hearing aids.

I hereby commend the Honorable J. J. Pickle for entering the (UBIT) for the people who sell Hearing aids. I have many proofs and ads but You know without me telling You.

I have hand written this so You are receiving its contents right from me personally.

F. Vanderhoof
Greeley

April 11, 1988

Robert J. Leonard, Cheif Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longsworth House Office Building
Washington, D.C. 20515

Dear Sir:

Reference discussions regarding reform of the UBIT system that applies to non-profit organizations.

The recognition of non-profit organizations is a rather ambiguous statement. Ex: Hospitals dispensing of hearing aids and other health-care at cut-rate-or-wholesale prices. Being in a private business we feel that this is a direct infringment of competition, and, a denial for those in business to attain a fair profit for products and services rendered. Lost tax dollars and these items, or, services, whatever it might be is costing the federal and state goverments immense amount of revenue, and, ultimately, driving some private, large and small, businesses to the brink of, if not to bankruptcy. This in turn is causing some un-employment, an added cost to the goverment and a deterioration in the economic field of private enterprise which is the basis of the whole U. S. economy. Another danger which is seldom thought of, is the indirect effect of the foriegn market. This non-profit regime is directly opening up the foreign market by driving our own out of business.

The old adage of "slap the one who feeds you-and-you go hungry" applies to this most serious situation. We pay for the privilege for being private and independent by our taxes-but we are willing to pay that amount for being free in a free country. Why restrict, sometimes strangle, that which our economic system is built on. Let those who supply products, whoever it may be, pay the piper. Save the tax payers money. All of us know someone is paying for these operations; mostly those who pay their fair amount and for freedom and compitition.

Thank you.

Sincerely,

Donald J. Kratz

Better Hearing Aid Service
101 1/2 S. Main St.
Wyckoff Bldg.-Suite 202
Celina, OH 45822

(Identical letter received from James Frysinger.)

BOCA MUSEUM

April 8, 1988

The Honorable
J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives

The proposed changes to the unrelated business income tax would be devasting to cultural institutions particularly throughout the southern United States.

Museums are currently suffering from recent and negative changes in the income tax law which have decreased the value of cash gifts and donations of art works to museums. To further this by an additional burden by punishing our own efforts to earn the additional income would be unjust.

Through the south cultural institutions are struggling to meet the ever increasing public demand for cultural programs and facility development. Certainly we lag far behind our northern communities, with the exception of a few cities, and if donations are not encouraged by the U.S. government we must have the right to earn funds through traditional income sources without further penalty.

We urge you not to adopt these restrictive and damaging proposals on museums.

Sincerely,

Roger L Selby

Roger L. Selby
Executive Director

RLS/dc

BOCA RATON MUSEUM OF ART
801 West Palmetto Park Road, Boca Raton, FL 33432 (305) 392-2500

Museum
of
Fine Arts
Boston
465 Huntington Avenue
Boston
Massachusetts
02115
(617) 267-9300

Office of the Deputy Director

April 13, 1988

VIA FEDERAL EXPRESS

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight, Committee on Ways and Means
c/o Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Re: Statement On Discussion Options Relating to Unrelated Business Income Tax

Mr. Chairman, Members of the Subcommittee on Oversight, Committee on Ways and Means:

I am Ross W. Farrar, Deputy Director of the Museum of Fine Arts, Boston, Massachusetts. In this capacity, I am responsible for the fiscal management of this institution, and in this regard, I respectfully request that you consider the following thoughts as you deliberate changes to the Unrelated Business Income Tax (UBIT).

Those of us who are directly responsible for the management of exempt enterprises which are particularly challenged by the proposed options to the UBIT are frustrated and demoralized by this latest effort to further impact our ability to raise the revenues necessary to support our institutions. We work for such non-profit organizations out of great respect for their role and importance in society, often at below market compensation. All the money earned by these challenged enterprises goes directly back to the institutions we serve for preservation of our cultural heritage and for program support--programs that attract an average of 900,000 visitors per year, and over 50,000 members in the Museum of Fine Arts' case. Not a penny goes to employee or owner bonuses or profit-sharing; not a penny goes to "stockholders dividends."

Cultural organizations have been encouraged over the past decade to solve their own fiscal problems, more and more. Appropriations and resulting federal grant funds to non-profit institutions have diminished as a result of this attitude. We do not take exception with that philosophy here, but we question why that philosophy now attacks the revenue sources we have sought to develop in response to such federal reductions.

We recognize that the subcommittee must be under particular pressure from a well-funded, well-organized lobby of small and not-so-small businesses, at what they consider unfair competition. If we were operating our business without paying taxes and personally pocketing the money, they would be justified. If we were drastically undercutting prices by virtue of our tax-exempt status and taking business away from the commercial enterprises, then we might understand their concern. However, the facts just do not support this, and we hope you and your subcommittee will ensure that your research staff carefully reviews product prices and quality in the mail order business, for instance, to determine the accuracy of such comments. I can assure you that we are not undercutting to take business away. That is not our purpose because we are in the business to make a profit as well, and that profit is returned to the institutions to support cultural programs.

We believe the real reason for such concern on the part of the business community is that we have been successful in competing with them--a good old American tradition. Had we been unsuccessful, you would never have heard a word. However, our success has come from lots of hard work, just as theirs has, and not from exemption from taxation. We have had to create the sales, provide the quality of product and the level of service, just like any other business, and this costs money, time and expertise. And, we have had a lot more restrictions along the way as well. We have always sought to create and offer quality products in our shop that relate to the collection, by both our own criteria and because of current IRS standards. We cannot arbitrarily enlarge our product line like our colleagues in the business community. We cannot add a radio to hang in a shower or a digital VCR to our product line just to sell more. We have had to create products within reasonably strict boundaries. I would say that the Museum has been faced with more obstacles in developing its business than many of its competitors. Yet, we compete, and compete effectively, and that is at the heart of the matter.

I trust that the subcommittee will carefully consider the issues at stake here, and I hope that my thoughts will be helpful in this regard. I only ask that you consider, in particular, that there is no personal gain at issue with exempt institutions in this matter. Whatever so-called "profit" is made, goes directly back to the institutions we serve and not to individual owners.

Respectfully submitted,

Ross W. Farrar, Deputy Director
Museum of Fine Arts, Boston

The Bostonian Society
OLD STATE HOUSE
106 Washington Street
BOSTON, MASSACHUSETTS 02109

Organized to Promote
the Study of the History of Boston
and the
Preservation of its Antiquities

April 12, 1988

APR 14 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Pickle:

I am pleased to respond to your request for public comments on options relating to the Unrelated Business Income Tax.

Respectfully I am offering my summary opinion that a major change in Unrelated Income Tax law would seriously reduce an important revenue source for many non-profit museums, and thus have a negative impact on their ability to provide services and operations. In the case of The Bostonian Society, a major portion of its financial resources are used to keep open and to interpret Boston's Old State House--one of the nation's most venerable buildings. Income from the museum shop contributes significantly and directly to the Old State Houses's operations. A reduction in revenue would have an equally significant and direct effect.

In addition, I would like to make two points.

1. When potential and ongoing corporate supporters of non-profits evaluate an organization they almost always look for evidence that the organization is doing all possible to earn money with museum-related activities before turning to the business community for the needed additional support. Putting it another way, is the organization doing everything possible to effectively manage its services, including exploring and exploiting all avenues of ethically raising "earned" income?

2. In the past few years, just about every administrator in the non-profit museum world has become very sensitive to the issue of Unrelated Business Income. In consequence, there has been an agressive review of the philosophy of purchase and sale of items in museum shops. In our own instance, among other standards, I have asked the shop manager to apply the rule-of-thumb when selecting for sale, "can you write a label for it if it was in one of the museum cases?"

In conclusion, major revisions in the law would have a negative impact on a museum's ability to carry out their mission; and though I am sure that abuses exist, in reality, a revision would be punishing a rather vast non-profit community because of the abuses of a very few.

Thanking you for your consideration I am:

Sincerely yours,

Joan C. Hull

Joan C. Hull
Executive Director

cc: Congressman J. Joseph Moakley

William B. Boudouris, Otometrist
Hearing Aids
5808 MONROE STREET SYLVANIA, OHIO 43560 419/885-3848

CERTIFIED/NHAS
NATIONAL BOARD CERTIFIED/HIS

April 12, 1988

To the attention of:
Robert J. Leonard, Chief Counsel
Committee on Way and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,
We who are suffering the cost of unfair competition from the nonprofit organizations are pleased with the work you have done so far. Please pursue the objective regarding reform of the Unrelated Business Income Tax System (UBIT) that applies to nonprofit organizations. These discussion options are very important to us.

All the hospitals in our area are dispensing hearing aids. The Toledo Speech and Hearing Clinic is dispensing hearing aids. Bowling Green State University is dispensing hearig aids. These organizations are spending large sums to advertise in the local newspapers. Furthermore, these organizations indulge in unethical advertising and do large amounts of advertising (especially the hospitals).

I strongly urge you to eliminate all hearing aid sales income by the nonprofits. You must know the bitterness I feel when I know that my hard earned money is supporting my competition. I cannot express strongly enough my negative feeling about this situation.

Please do not fail to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

Please note the two articles, one taken from the Wall Street Journal and the other from the Toledo Blade. The Blade article referring to the Mercy Hospital catering business is especially appalling. The highly government funded hospital is embarking upon a new aspect of restaurant business without any regard for the persons who are in the restaurant or catering business without government assistence. I would love to have the federal government pay 25% of my operating costs (probably a lot higher percentage). The other article points out how quickly persons working for a government organization will grab an opportunity to embark upon a business, using any excuse, even though the others competing against them are not tax funded.

Sincerely,

William B. Boudouris
William B. Boudouris

THE BLADE: TOLEDO, OHI

'Yellow & Whit

Hospital

By MARY-BETH McLAUGHLIN
Blade Staff Writer

THE
MOBILE
CHEF
MOBILE
CHEF

A new business in town may soon give a whole new meaning to the term "hospital food."

The Mobile Chef, a catering service staffed by workers of the food and nutrition services department of Mercy Hospital, began operations this week.

Now, employees of uptown and downtown businesses can enjoy sandwiches — plus a salad, dessert, or fruit — delivered, for prices that do not exceed $3.50. The lunchtime service is available Monday through Friday, and the free delivery area from the hospital, located at 2200 Jefferson Ave., ranges east to the river and west to the Westgate area.

Service is saving jobs

"This is providing employment for my employees and is providing a service for the people in the area," said Beth Blankerts, a registered dietitian and director of the food and nutrition services department.

Miss Blankerts said the mobile catering service is a response to the increased emphasis on out-patient treatment, which has reduced the number of patients taking meals at the hospital.

"I wanted to increase the volume of my department. There are only so many [hospital] employees and patients you can feed in a day, so I had to go outside to do it," she said.

In addition, she knew there were not many eateries near Mercy.

"So many people who work in buildings next to ours come to eat in our cafeteria for lunch, even on cold and rainy days," she said.

Orders must be made early

The only restriction on orders is that they must be placed by 9:30 a.m. Miss Blankerts said the staff arrives at 8 a.m. and begins to make the salads, desserts, and sandwiches to order.

A driver and a runner start their deliveries about 10 a.m. and have all the meals delivered by 11:30 a.m.

The sandwiches are basic luncheon fare, sporting such names as The Old Fashioned (ham on rye with swiss cheese), French Connection (croissant sandwich with ham, cheese, lettuce and tomato), and the Yellow & White Delight (egg salad sandwich on white bread).

Although the hospital's dietitians limit their services to patients, the Mobile Chef is staffed part-time by four food preparation workers who had been working in the hospital's kitchen.

Because the hospital is a not-for-profit organization, a separate enti-

e Delight to go'

meal service catering to callers

ty had to be formed to handle the purchases and revenues for the for-profit catering business, said Ron O'Neal, vice president of Mercy Hospital. However, the hospital's kitchen facilities are used, and the hospital donated an old van for the deliveries.

"We've been using this on a limited basis for the past several weeks and have had a very positive response," Mr. O'Neal said. "We're starting rather small and just hoping to continue to grow."

Garnering business through word of mouth and a mailing to area businesses, the Mobile Chef staff has already delivered to the Spitzer building, to companies on Madison Avenue, and to the Toledo Municipal Courthouse.

Miss Blankerts said she has a goal of making up to 100 meals a day.

"We have an infinite capacity and as the business grows, we can increase the hours [of workers] or increase the staff," she said.

Daily lunches are not the only meals the Mobile Chef provides. It is also in the catering business at night and weekends for such events as wedding receptions, office and retirement parties, confirmations, picnics, and tailgate parties. In that case, orders must be placed a week to 10 days before the event.

"We try to be real individual and find out what they need . . . and their personal likes and dislikes," Miss Blankerts said. "We try to talk to a person and find out what kind of atmosphere they are going to have. If it's going to be casual, you don't want to have prime rib."

School Child-Care Programs Stir Debate

Advocates See Social Benefits; Critics Cite Cost

By CATHY TROST

Staff Reporter of THE WALL STREET JOURNAL

For $55 a month, Debra Bucher can buy this much child care: weekdays from 6:30 a.m., nights and weekends, special accommodations in case of illness—all of it available the year round.

Who baby-sits for the 28-year-old single mother of three? The public school system in suburban Los Angeles.

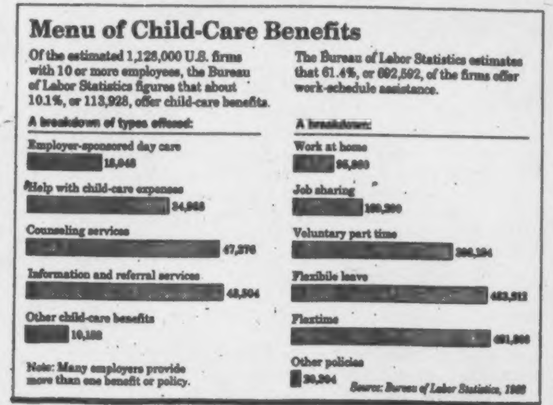
Near St. Louis, parents can find year-round care up to 11½ hours a day for preschoolers as young as 2½ years old, as well as programs for older children before and after the regular school day. The maximum fee: $68 a week. Here, too, the provider is the local public school.

Innovative proposals to reshape the way the nation cares for its children are gaining ground in the states and in Congress. And one of the most hotly debated is the notion of public school as nanny. The idea, simply put, is to expand the schools' hours, and keep them open all year long, in order to provide both quality day care for preschoolers and care before and after regular school hours for older children. Among the advantages, supporters say, are greater affordability and quality developmental programs.

But while this approach strikes many as a canny solution to the need for more and better child care, it has also given rise to some critical questions. Should—and can—the schools, many of which are already overburdened, take on the added reponsibility? How sharply should the line be drawn between the schools' educational and care functions? And not least, who will pay?

'The Jury Is Still Out'

"The issue of public schools offering day care is an issue that communities are becoming more and more attuned to," says Gary Marx, associate executive director of the American Association of School Administrators. "But the jury is still out on how that ought to be provided."



Menu of Child-Care Benefits

Of the estimated 1,128,000 U.S. firms with 10 or more employees, the Bureau of Labor Statistics figures that about 10.1%, or 113,928, offer child-care benefits.

The Bureau of Labor Statistics estimates that 61.4%, or 692,592, of the firms offer work-schedule assistance.

Note: Many employers provide more than one benefit or policy.

Source: Bureau of Labor Statistics, 1988

There are questions, too, about the linking of child care and education in the schools. Most advocates insist that such programs primarily involve activities that help a child's development, with lots of play and socialization. But there is fear that, as the programs multiply, academic pressures will eventually bring about increased regimentation.

"You can't make it simply a miniature first grade," cautions David Elkind, a Tufts University professor of child study. "What is not appropriate is workbooks and grades and tests," he adds, but animals and plants, sand tables and other materials "so children are learning mostly through interacting."

Perhaps the biggest questions, though, are financial. The cost of a publicly subsidized system of full-day child care approaches "the order of magnitude of what we now spend on schools," says Norton Grubb, an education professor at the University of California, Berkeley. Since it is unlikely that amount of money will be committed, he argues, any public subsidies for such programs should be "concentrated on poor kids with sliding fee scales for middle-income kids. It's bananas to think the federal government is going to pay for it all itself."

A proposal for a sweeping program of public-school child care by Edward Zigler, a professor of psychology and co-founder of the national Head Start program, addresses some of these concerns.

Mr. Zigler's plan, which has stirred national attention and shaped legislation now under consideration in Congress, would establish two systems in existing public school buildings, one for formal education and one for child care. There would be child care for children ages three to 12 before and after regular school hours and during school vacations. Children ages three and four would be only in child care, not formal schooling, and he recommends a half day of education and a half day of child care for five-year-olds who need it.

The child care would emphasize developmental needs through play and socializing experiences. Programs would be run not by school personnel but by degree holders trained in early-childhood education. And schools would serve as the hubs for community networks of family homes, centers and other providers of care.

Mr. Zigler optimistically envisions sliding-scale fees based on income until enough women are working so that "this nation will not be opposed to a tax for child care." At the point where about 80% of all working-age women are in the labor force, he theorizes, program costs would be absorbed through property taxes—a notion that has aroused some skepticism.

To make Mr. Zigler's vision a reality, Sen. Christopher Dodd, a Connecticut Democrat, has introduced legislation to set up a model child-care system within the public schools. The $120 million bill would pay for prototype projects in each state that would provide on-site child care for children between the ages of three and 12, along with other family support.

Sen. Dodd is also sponsoring a $2.5 billion package to expand the availability and affordability of day care nationwide. "Women," he says, "are tired of lying to their bosses about their car being broken."

PAGE 17
FRIDAY, APRIL 8, 1988

THE WALL STREET JOURNAL.

The idea of child care in public schools isn't new. Many day-care centers were funded in public schools when women went to work during World War II, but most closed when women went back home. Now demographics are making such alternatives worth exploring once again.

Today there are more children under age five than at any time since the middle 1960s, and with far more of their mothers working outside the home. About 57% of the mothers of preschool children—and 72% of the mothers of school-age children—are in the work force, according to the Bureau of Labor Statistics. Studies cited by David Bloom, a Columbia University labor economist, show that about one-fifth of mothers with preschool children either aren't working as much as they'd like or don't work at all because they can't find good, affordable child care.

To help meet the need, a few schools have forged ahead on their own, and interest is growing among states and cities.

A 1986 survey of 1,200 school districts by Bank Street College of Education and Wellesley College found 8% with programs for four-year-olds that are geared to child-care needs over the full school day. Most of the districts' programs, by contrast, are only part-day, and many are driven not by child-care needs but by a surging belief in the social benefits of early-childhood education, especially for the poor.

Funded by Tuition

Those school districts that have the programs are typically small and suburban, with motivated superintendents and citizens who can afford to pay for the care, says Anne Mitchell, co-director of the Bank Street-Wellesley survey. Thus, most programs resemble the one outside St. Louis, which is run by the Lindberg and Affton school districts and is almost entirely supported by tuition fees.

There are exceptions. For example, the program that Ms. Bucher uses, which is run by the Pomona Unified School District in suburban Los Angeles, is almost totally state subsidized. Most parents in the program—about 85% of them single—pay rates based on income and family size. Even for families with several children, total fees average about $8 a week, compared with an average of $55 weekly for other programs in the area.

The Pomona program offers a pageant of options at various schools, including such extras as infant and toddler care, night care as late as midnight and emergency care for families under stress. Its curriculum is "age-appropriate," with a mix of developmental and other activities, says Bill Ewing, the district administrator of child-development programs. While the program formally began nearly two decades ago, such features as sick-child care were added only in recent years. It now has an enrollment of about 900 children and a waiting list of more than 1,000.

Despite such successes, not everyone agrees that public-school programs are the answer. Some critics argue that most schools lack the room and resources to make child-care programs feasible.

"The vision (of public-school child care) is one of a variety of ways to go," says Sharon Kagan, director of policy analysis in the New York City Mayor's Office of Early Children's Education. "But what's happening is that visions for the future are colliding with the realities of the present. Some schools are so overcrowded you couldn't put another pencil in them."

Mr. Marx of the school administrators group adds that, although many administrators wholeheartedly support the idea, "others would tell you they have their hands full with their current programs and funding would be a real problem."

BRANDYWINE CONSERVANCY P.O. BOX 141 CHADDS FORD, PENNSYLVANIA 19317 215/388-7601 • 459-1900

April 13, 1988

Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Re: Discussion Options Relating
to the Unrelated Business
Income Tax

Gentlemen:

The following comments are submitted by the Brandywine Conservancy and its Brandywine River Museum in response to your request for comments on the discussion options relating to the unrelated business income tax.

Our organization must be greatly concerned by the options because taxation of revenues derived from traditionally tax free income sources reduces net income. Like most not-for-profit service organizations, we utilize all available income for programs and do not have other sources of funds that can make up for income lost to taxes. We beg the Subcommittee to consider the ultimate, negative effect on the public welfare of any increase in the taxation of public service institutions which will cause reduction or elimination of services. We also beg the Subcommittee to consider the effect of increased Federal taxation of not-for-profits on local taxing agencies who, encouraged by a Federal model, are likely to mount new tax initiatives of their own.

This letter responds by item number contained in your press release #16. It responds to those items of obvious concern to our organization and, therefore, to those items with which we have the most experience.

I.A. This is a proposal with potential for great damage to museums and other educational institutions. It would: 1) reduce revenues supporting public programs through the introduction of new taxes, and 2) threaten to make accounting so difficult that institutions' shops would reduce the type and number of significant educational materials they offer to their public. Furthermore, and perhaps most importantly, it will trivialize the materials offered by such shops by emphasizing "mementos" of no educational value over books and other truly educational materials related to the purposes of institutions. This result cannot be good public policy. This option is precisely opposed to the current relatedness test.

BRANDYWINE RIVER MUSEUM • ENVIRONMENTAL MANAGEMENT CENTER

Another question regarding option I.A. is who will make the decisions regarding what is and is not "low cost" or a "memento"? If the decision, as seems likely, would finally be made by an agent of the IRS, it must be said that such agents are not well equipped to make such judgments.

I.D. To tax the small revenues derived from travel services would almost certainly cause us to eliminate them, to the detriment of both our members' education and our institution for the following reasons. 1) Travel services offered to members of educational institutions do not produce significant revenue. Rather they are educational ventures taking our members to significant sites related to our purposes as institutions. 2) We offer such travel services to bring new members into our organization (because, under the law, only members can take advantage of the travel we organize.) New members become future donors and supporters of our institution.

I.L. The application of UBIT to additional specified activities determined to be inherently commercial is a vague threat to our future. There is no way to adequately respond to this sword held above our heads. Who is to make the determination of "inherently commercial" activities, and when?

IV. Implementation of this option avoids serious damage to museums only if the proposed exception (for "products that are part of the organization's exempt function") clearly includes publications, films, and other materials that result from research conducted by our organizations. Otherwise, we might be required to pay taxes on royalties from books written under our direction by individuals in our employ on subjects properly addressed by our institutions. In that case we would be paying taxes for carrying out a primary function made possible by such royalties.

IX. We support this option because there is a need for more information regarding not-for-profit organizations and for more careful oversight. We support stricter enforcement of UBIT rules and better data collection by the IRS and the U.S. Bureau of Census because every non-profit should pay its fair share of taxes on unrelated business income. However, we strongly support existing unrelated business income tax rules which serve as a proper and useful standard for distinguishing exempt from taxable income and constitute a logical, generally understood approach. The overwhelming majority of tax-exempt organizations adhere to the laws which have allowed us to develop and provide public services and function as non-profits for dozens of decades. It would be counterproductive and unsettling to now change those laws. Moreover, at a time when the Federal government is attempting to reduce its role and encourage private sector initiatives, it would be a contradiction to send more tax monies to Washington and threaten the survival of the non-profit sector of our society.

Sincerely,

James H. Duff
Executive Director

JD:fwn

c: The Honorable Richard T. Schulze

[redacted]

April 11, 1988

J. J. Pickle - Chairman
242 Cannon House Office Building
Washington, DC 20515-4310

Dear Congressman J.J. Pickle:

I want to commend you and the Ways and Means Subcommittee on Oversight for the time and effort you have devoted to the issue of unfair competition from tax-exempt organizations. As a for-profit tour company which has experienced first hand the serious problems associated with commercial competion from tax-exempt organizations, I can assure you that your efforts are most appreciated.

I am aware that the Subcommittee is considering a set of discussion options for addressing unfair competition. All of these options represent important steps in the right direction. One particularly significant option is to apply the Unrelated Business Income Tax (UBIT) to certain specified activities, including tour and travel services. These activities are commercial in nature. Therefore, if a tax-exempt organization engages in these, they should be treated as taxable activities. This is an extremely fair approach in that it provides an eqitable and consistent method of addressing commercial activity, reqardless of the type of organization carrying out that activity.

I encourage you to support the options now being considered by the Subcommittee. In doing so, you will be striking a blow for fairness in the marketplace and you will be providing a great service to countless struggling small businesses across America.

Sincerely,

Pamela Brenner CTP
President

PB/et

nta NATIONAL TOUR ASSOCIATION
ABA AMERICAN BUS ASSOCIATION
OFFICIAL WEST MICHIGAN WM MEMBER

MEMORANDUM

TO: Subcommittee on Oversight, Committee on Ways and Means
FROM: Thomas J. Brorby
DATE: April 14, 1988
RE: Comments to UBIT - Discussion Options

The Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives released a list of discussion options regarding the unrelated business income tax on March 31, 1988. This list was a follow-up to the series of hearings held by the Subcommittee in June 1987. An accompanying press release stated that comments were to be submitted to you by April 15, 1988. Our law firm practices extensively in the tax-exempt organization area. Enclosed are our comments with respect to these discussion options, which are generally from the perspective of charitable organizations exempt under Section 501(c)(3), especially with respect to organizations conducting medical or scientific research.

BACKGROUND OF THE UBIT

In response to concerns about unfair competition to taxable businesses from tax-exempt organizations, Congress enacted the unrelated business income tax ("UBIT") in 1950. It applies to otherwise tax-exempt organizations and subjects the income arising from any business activities unrelated to the organization's exempt purposes to tax. If the conduct of a trade or business is substantially related to the exempt purposes, the income earned therefrom is not subject to UBIT. In addition, traditional passive sources of revenue for charitable organizations, such as dividends, interest, annuities, royalties, and rents are generally excluded from the UBIT.

COMMENTS ON THE DISCUSSION OPTIONS

In considering the various discussion options, the rationale for tax exemption (i.e., that organizations described in Section 501(c)(3) serve the general public interest) needs to be kept in mind. The policy is that since taxes represent a removal of resources from private hands to support the broad public purposes served by the government, and that since the same general purposes are served by this type of exempt organization, income earned by such an organization is appropriately exempted from tax.[1]

Scientific and medical research serve the public interest, and accordingly, Congress has exempted entities organized and operated for such purposes under Section 501(c)(3). In addition, medical research organizations are one of the classes of organizations expressly singled out for favored treatment with respect to the limitation on deductibility of contributions and exemption from the private foundation rules of Chapter 42 of the Code. Furthermore, in addition to exemption itself, the federal government provides numerous other incentives for research in the exempt sector (e.g., research grants to universities and other exempt organizations; the Uniform Federal Patent Policy Act, which gives universities ownership rights to patents developed as a result of federal funding of research; and special tax deductions for certain contributions of scientific equipment to such organizations). All of these incentives for research reflect the critical importance of research to the national economy and the belief that some research activities would not be adequately supported by the private sector in the absence of governmental incentives.

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[1] See statement of Assistant Secretary O. Donaldson Chapoton before the Oversight Subcommittee of the Ways and Means Committee, June 22, 1987 (hereafter referred to as the "Chapoton Statement").

Before making any specific comments, we would like to point out that the discussion options are very brief and without further explanation it is difficult to ascertain the scope or meaning of some of the provisions. Furthermore, only two weeks were provided for comment. Notwithstanding the above, this letter attempts to provide constructive comments.

1. Change to Royalty Provision. With respect to the option to tax royalties based on net income, we question whether differences in the method of measuring the economic return to the exempt organization should be determinative. A royalty of this type does not mean that the exempt organization is involved in the commercial decision-making or operations, nor in the sharing of business risks. An investment seems no less passive in nature because the return is based on net income (e.g., dividends are more closely correlated to net income than gross income). If the real concern is with amounts being disguised as royalties which are in reality something else, current law provides the ability to deal with this.[2]

Medical research organizations, organizations exempt because they primarily conduct scientific research, and other organizations such as hospitals and schools which conduct scientific and medical research may be adversely impacted by the proposal to tax royalties received by an organization for the use of property created or developed by the organization. This proposal was not included in the October 29, 1987 recommendations of the Republicans on the oversight committee or any other proposals we are aware of. Why should the tax law favor purchased property created and developed by someone else over a product created by the organization itself? It seems that organizations involved in the conduct of medical or scientific research are the most likely to have situations where royalties may arise with respect to property created or developed by the organization.

Congressional policymakers should consider that licensing the products of research often is the only way that the benefits of the research can practically be made available to the public. This is so because there is no economic incentive to spend the money necessary to create a product and develop a market if others can wait until after these expenditures are incurred and then enter the field and take a share of the profits without incurring any of the costs. Two points to bear in mind are that the objective of advances in the fields of science and medicine is the creation of new products and procedures for the benefit of the public and that licensing the products of research is an essential and necessary component of making the fruits of research available to the public.

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[2] See Section 1.512(b)-1 of the Regulations providing that the characterization by the parties of a payment as a royalty will not determine its character for tax purposes.

The Subcommittee on Oversight obviously recognizes the relationship between licensing and a research organization's public purposes, as the discussion option would except "products that are part of the organization's exempt function." If royalties with respect to property created by an organization do become taxable, the scope of this exception becomes critical. It should be broad enough to serve the desired objective. The exception language should at least make it clear that all products developed pursuant to research conducted in furtherance of the organization's exempt function will be covered, rather than being limited to "products . . . part of the . . . exempt function." The specific concern being focused on with this suggestion is with products, procedures or devices developed in the course of exempt medical or scientific research that by chance also have useful non-medical or non-scientific functions. Because such products are the result of exempt behavior, the resulting royalties should be excluded from UBIT.

As stated above, medical and scientific research are the activities most likely to create or develop property with respect to which royalties will be generated. Most of the products likely to be created or developed would fall within the exception contained in this discussion option for exempt function products. Given these two likely facts, does it make sense to enact a rule with an exception such that the exception swallows the rule? Furthermore, in the first instance, how can it be good policy to enact a disincentive targeted at the creation of new products?

In considering any changes in the treatment of royalties, Congress needs to consider whether the real world effects of change would exacerbate the problems being complained of by the private sector. If the tentacles of the UBIT are expanded such that it reaches into additional areas, it is possible that this expansion in coverage could have the effect of increasing commercial involvement by exempt organizations. In the context of research, for example, if UBIT attaches at the creation stage of research such that a UBIT reporting and tax burden cannot be completely avoided, would the exempt organization be more likely to also do further development and marketing itself, rather than licensing the product to a for-profit competitor as it would do under current law in order to avoid UBIT entirely? Treasury shares this concern.[3]

2. Definition of Research. Although the discussion options do not include an option which would change the definition of "research" for UBIT purposes, the October 29, 1987 recommendations of the Republicans on the Oversight Subcommittee propose narrowing the definition of research to cover only research which is available to the public and which is "basic." In this regard, applied research is often an essential and necessary component of bringing the fruits of the basic research to the public. The line drawn under current law -- exempt research does not include activities of a type carried on as incidental to commercial or industrial operations -- is sufficient. Any narrowing of the definition of "research" for UBIT purposes would be unwise and inconsistent with the policy justifying exemption.

3. Inherently Commercial Activities. Also included as a discussion option is the application of the UBIT to additional

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[3] See Chapoton Statement.

activities determined to be "inherently commercial." Could research be considered inherently commercial because there are numerous pharmaceutical and other types of corporations conducting research in the areas of science and medicine? At the threshold, it is clear that there is, and there will always be, competition between the research conducted by exempt organizations and that conducted by taxable corporations. It would be unwise as a policy matter to in effect revoke the exemption of organizations conducting medical and scientific research by instead subjecting the income from these activities to the UBIT under a theory that such research is in direct competition to that conducted by the private sector and is therefore inherently commercial. (This example may also show how the "inherently commercial" approach will likely be unworkable in many other contexts.)

4. Definition of "Control". The Subcommittee includes several possible options to the current UBIT treatment that results from the use of subsidiaries by an exempt organization. One option would modify the definition of "control" to mean ownership directly, indirectly, or by attribution of at least 50 percent of stock by vote or value as compared to the existing definition in Section 512(b)(13), which requires direct ownership of 80 percent of combined voting stock and all other classes of stock. While there may be problems in the current law, this option goes much further than necessary. If the abuse seen is the lower effective rate of tax caused by the payment of excessive amounts of royalties, this could be dealt with by Section 482 concepts allowing deduction in the amount of only an arm's-length royalty.[4] Fifty percent ownership is surely not enough to find that the entities should be treated as affiliated for this purpose.

5. Allocation Rules. Another of the discussion options which merits comment is the proposal to not allow a deduction against UBI for an allocable portion of overhead or depreciation with respect to facilities used for exempt purposes as well as unrelated business purposes. Rather than ensuring that exempt organizations are on an equal tax footing with the for-profit sector when conducting an unrelated business, this would put exempt organizations at a disadvantage because deductions for these items are available to the private sector. As such, the concept is unfair on its face. If there are problems in this area, they can be adequately addressed under existing law by enforcing an appropriate allocation between exempt and unrelated purposes.[5]

6. Consolidated Return. Finally, the proposal that affiliated groups including an exempt organization file a consolidated information return also merits comment. One problem is determining "affiliation" in the nonprofit organization context. Since generally nonprofit organizations have no "ownership" percentage to look to (i.e., no stockholders), but instead are considered owned by the public or for the benefit of some particular class, this determination as to affiliation often could not be made in the normal manner. Some other method for making the

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[4] See also the regulation cited in footnote 2.

[5] Section 1.512(a)-1(c) of the Regulations provides that where facilities and personnel are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses, depreciation, and overhead are to be allocated between the two uses on a reasonable basis.

determination would need to be devised. Looking at the composition of the board of directors for this purpose could result in the finding of an affiliated group where there is no connection of any kind between two or more organizations, other than the identity of certain board members. Any method for determining affiliation would need to be extremely subjective (as under current Section 482) which would be difficult to apply in the non-profit context, or, if mechanical, subject to the same types of avoidance for which Section 512(b)(13) is criticized.

CONCLUSION

While acknowledging that some abuses have occurred in the UBIT area, because the objective behind the charitable exemption and the scope of the UBIT has always been to favor efforts in the public interest, any changes need to be very carefully considered. It is disturbing that an often-stated reason for the current impetus to change the law with respect to UBIT is that this area has not been significantly changed in many years. Established rules based on sound policy should not be changed for the sake of change; rather, changes should be made only for a good reason and after thorough consideration of all the ramifications. Hopefully Congress will not see fit to engage in legislative overkill of the type visited on private foundations under the Tax Reform Act of 1969 in which the provisions enacted have created complexity, confusion, administrative difficulty, and expense to charity completely disproportionate in scope to the few well-publicized abuses providing the impetus for the legislation.

One answer to some of the concerns in this area that should not be overlooked is the enforcement of existing law. According to the IRS, many organizations do not timely file Form 990-T and, with respect to those that do, there is pervasive underreporting of income and overreporting of expenses.[6] In addition, the Small Business Administration has criticized the forms currently in use as not requesting sufficient information for the IRS to determine either the degree or the type of activity engaged in by nonprofits and as failing to request enough information to reveal any activities' connection with the organization's exempt purpose.[7] Appropriate changes in the reporting forms and increased compliance with existing law may be sufficient without making wholesale changes accompanied by uncertain, and possibly detrimental, ramifications.

In conclusion, the importance of medical and scientific research to the public and to the country as a whole should not and cannot be lost sight of. In considering the extent and scope of changes to the UBIT, medical and scientific research efforts should as a policy matter continue to be favored, and, in carrying out such policy, any changes to the mechanics of the UBIT should not adversely impact the mechanisms by which the fruits of research are made available to the public. Any tax advantage can and should be justified as "an intended consequence of the societal decision to encourage the exempt functions performed by these organizations."[8]

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[6] Comments of Howard Schoenfeld, Special Assistant to the Assistant Commissioner (Employee Plans and Exempt Organizations) contained in the IRS News Release of February 25, 1988, Commissioner's Exempt Organization Advisory Group, Minutes of September 16 and 17, 1987 Meeting (as reported in March 1, 1988 Tax Notes Today).

[7] See letter from Charles A. Caldwell, Deputy Chief Counsel for Advocacy, U.S. Small Business Administration, to Don Alexander, dated February 2, 1988, also contained in the March 1, 1988 Tax Notes Today.

Thomas J. Brorby, Esq.
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[8] Chapoton Statement.

EXECUTIVE OFFICE
Brown County
305 EAST WALNUT, P. O. BOX 1600 • GREEN BAY, WISCONSIN 54305-5600
PHONE (414) 436-3355

THOMAS D. CUENE
COUNTY EXECUTIVE

April 13, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

RE: Discussion options relating to the unrelated business income tax.

Dear Mr. Leonard:

I wish to express my objections to the numerous "discussion options" currently being considered by the House Ways and Means Oversight Subcommittee on the issue of taxation of non-profits' revenue-producing activities.

While these measures would certainly increase the government's revenue on a short-term basis, I believe that over a period of years, it would be crippling, not only to non-profits, but to the government and its citizens as well. The options will have two effects - to drastically reduce the services which are offered to the public or conversely increase the cost of these services thereby making them unavailable to a large segment of the population, or in the worst case, cease the services since the non-profits will be forced to close their doors. This is not an acceptable situation either for Brown County nor the United States.

I ask you to proceed with much caution in debating these issues and to look beyond a short-term, short-sighted policy which could destroy the fabric of non-profit services now available to the people of this country.

Sincerely,

Thomas D. Cuene

Thomas D. Cuene
County Executive
Brown County Wisconsin

c.c. Toby Roth

BROWN HEARING AID CENTERS
105 CAMELLIA P.O. BOX 61
ORANGE, TX. 77630

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of REpresentatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I want to commend you on your thoughtful consideration of the REFORM of the Unrelated Business Income Tax System that applies to NON-PROFIT organizations. In particular, I would like to urge you to apply this U.B.I.T. to all HEARING AID SALES by NON-PROFIT organizations. HEARING AID SALES by NON-PROFITS is strictly commercial in nature and is in direct competition with ME, a taxpaying businessman. NON-PROFITS have affected me in as much as they sell the hearing aids at very reduced prices. Well, they can do this because they do not have to pay taxes, they do not have to advertise (they have built-in clientele) and their operating expenses are funded by generous contributions. The survival of my business depends on my ability to be competitive in today's market. It is very difficult to compete with a NON-PROFIT, NON-TAXPAYING, CONTRIBUTION SUPPORTED BUSINESS. Please help stop this UNFAIR COMPETITION by NON-PROFITS, particularly in HEARING AID SALES. Your support for reform of the U.B.I.T. system that applies to non-profit organizations will be appriciated by many businessmen across the nation.

Respectfuly,

L Brown KT

Lee Brown

LB/IB

(Identical letter received from Karlene Toohey.)

BROWN-POTTER HEARING AID CENTER
3740 East Seventh St.
Long Beach, CA 90804
(213) 433-6701

APRIL 14, 1988

ROBERT J. LEONARD, CHIEF COUNSEL
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D. C. 20515

DEAR MR. LEONARD:

TO MAKE MY "CRY" FOR FAIRNESS HEARD, I AM WRITING THIS TO EXPRESS MY VIEWS ON THE NON-PROFIT ORGANIZATIONS.

I AM ONE OF THE SMALL BUSINESS PEOPLE OBJECTING TO THE USE OF NON-PROFIT WHEN THE PRACTICES BEAR NO RELATION TO SO-CALLED NON-PROFIT!

IT SHOULD BE ESPECIALLY APPLICABLE THAT NON-PROFIT ORGANIZATIONS OF ALL KINDS SHOULD BE FORCED TO PAY TAXES ON ANY AND ALL SALES OF MERCHANDISE TO THE PUBLIC JUST THE SAME AS ANY BUSINESS IS DOING.

I WISH TO COMMEND THE SUBCOMMITTEE FOR PROPOSING AN EXCELLENT PACKAGE OF REFORM MEASURES, AND I HOPE THEY WILL INCLUDE ALL THESE MEASURES IN THEIR FINAL REPORT, AND ESPECIALLY URGE THEM TO APPLY UBIT TO ALL HEARING AID SALES INCOME TO NON-PROFITS. THESE SALES ARE STRICTLY COMMERCIAL SO SHOULD BE SUBJECT TO TAXING. I ALSO HOPE THE SUB-COMMITTEE WILL CONSIDER A REPEAL ON EXISTING " CONVENIENCE" EXEMPTION FOR PATIENTS.

THERE ARE A GREAT NUMBER OF NON-PROFIT INSTITUTIONS IN MY AREA WHERE I HAVE TO COMPETE AS A SMALL BUSINESS PERSON PAYING TAXES ETC AND WHILE THEY OPERATE SELLING MERCHANDISE UBDER THE GUISE OF NON-PROFIT.

PLEASE HELP ALL OF US SMALL BUSINESS PEOPLE

VERY TRULY YOURS,

Sallye B. Carpentier
SALLYE B. CARPENTIER
OWNER- DISPENSER

April 11, 1988

Buffalo and Erie County Historical Society Founded 1862
25 Nottingham Court · Buffalo · New York 14216-3199 ☎ 716-873-9644

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to express my deep concern about proposed changes to unrelated business income tax regulations. Many of the options being considered by the House Ways and Means Oversight Subcommittee would be damaging to museums in general. They would be particularly damaging to institutions in Western New York which constitute one of this region's most important competitive advantages in its ongoing efforts toward economic revitalization.

A recent report by the Greater Buffalo Development Foundation has noted that for a variety of reasons Buffalo and Erie County's cultural institutions are more heavily dependent on public funding than similar institutions in peer cities. All of us in the field have felt a need to reduce that dependence and have been working to do so. Earned income is one area that is cited by the report as a particularly promising opportunity for local institutions. Most of our arts and cultural organizations are far behind those in peer cities in developing revenue from bookshops and similar activities.

In the last two years this institution has made significant strides toward generating income from shop sales, catalog sales, and rental of facilities in our building. This has contributed toward reducing our level of county funding from 70.1% of operating income to 42%. We must creatively pursue opportunities to further reduce levels of public funding. If new sources of revenue are taxed at higher rates, it will severely impair our ability to serve this community.

Institutions like this one in an area like Western New York have a vital role to play. We are an asset in efforts to increase tourism. For example, the Greater Buffalo Chamber of Commerce uses our building as a site for Familiarization Tours to acquaint out of town tourist promoters with the region. We are an asset in recruiting new middle managers to the area. Several major local employers use our materials to demonstrate the high quality of life our region has to offer. We are an asset in providing materials that inform planning for the future and assist the historic preservation efforts that give this region a unique and attractive character.

Local public agencies and businesses have recognized the value of the services cultural organizations provide, and have been generous in their support. That generosity alone is not sufficient. We need to develop sources of earned income in order to survive. Increased taxation of those sources would be a disservice not only to the institutions involved, but to the health of the region in general.

Sincerely,

William H Siener

William H. Siener
Executive Director

WHS/rc

Buffalo Veterinary Clinic
North Highway 25, R.R. 1, Box 6
Buffalo, Minnesota 55313
Telephone: 682-2181 or 473-2267

April 13, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

As a veterinarian in private practice, and as the District VI Representative on the American Veterinary Medical-Association's Executive Board, I would like to comment on activities and proposed actions of the Oversight Subcommittee relative to unfair competition issues and the unrelated business income tax (UBIT).

First let me commend Chairman Pickle and the whole subcommittee for an excellent package of long overdue reform measures, and encourage the subcommittee to include these measures in its final report. I would especially encourage repeal of the "substantially related" test and its replacement by "directly related" test. In the section dealing with charitable organizations and their certain animal health services, I would request that you consider wording changes similar to the following:

"all animal health services performed by a charitable tax exempt organization should pay tax on the income derived from those services with the following exemptions:

a) Services performed on animals actually owned or in bona fide legal custody of the charitable organization. (Ownership for a short period of time with the intent of circumventing this provision would be prohibited.)

b) Animals owned by indigent persons able to prove that they cannot pay for service.

c) Services performed by an educational institution engaged in teaching clinical veterinary medicine.

d) Spay and neuter procedures where a need, and effect on pet population can be demonstrated."

In my opinion, any animal health services not directly related to the charitable mission of the organization should pay income tax on profits over and above the actual expense of operating that segment of the organization. Veterinarians in general realize the necessary role fulfilled by most of these charitable organizations, and support their activities. However, when charitable organizations are allowed to conduct full service veterinary practices without the same tax structure imposed upon private enterprise, totally unfair competition exists. This unfair advantage is evident in the fees charged in comparison to fees in private practice.

Sincerely,

S E Held DVM

Stanley E. Held, D.V.M.

cc: Congressman Bill Frenzel
AVMA Governmental Affairs Office
Dr. Art Freeman, AVMA Executive V.P.
Dr. Arnold Hentschl

Veterinarians bristling over clinic's prices

By SHARI LAIACONA
Palm Beach Post Staff Writer

JUPITER — A statewide veterinary group is trying to change the way a local Humane Society animal clinic is doing business, but the clinic director says vets are trying to put it out of business.

The clinic, operated by the Humane Society of Jupiter-Tequesta, is the only one of its kind in Florida. It offers a wide range of basic veterinary services and supplies.

Private veterinarians say its status as a nonprofit — and tax-exempt — charity gives it an unfair advantage and takes business away from them.

If the veterinary group succeeds, it would be bad news for Josette Billian of Jupiter, who takes her three dogs and five cats to the clinic on Indiantown Road for care.

"It's a lot cheaper at the clinic," Billian said Wednesday. "The veterinarian treats me good and treats my animals good. I would recommend it to anyone."

Although each private vet sets his own rates, the clinic charges up to 80 percent less for sterilizations, vaccinations, minor medical procedures and supplies, according to an informal survey of local vets this week.

Please see VETS/12A

12A · THE PALM BEACH POST THURSDAY, MARCH 24, 1988

Clinic in the doghouse with veterinarians

VETS/from 1A

For example, it charges $20 to spay a cat, while prices quoted by private veterinarians ranged up to $95. All vaccinations cost $5 at the clinic; private veterinarians contacted said they charged up to $20.

Kay-Lynette Starling-Roca, executive director of the clinic, said the society started the operation last April because its members wanted to make sure care was available to all animals without regard to owners' ability to pay.

Although it is one of several low-cost animal clinics in Florida, the center is the only full-time, nonprofit clinic in the state.

'A living hell'

"Local vets have made it a living hell for us," Starling-Roca said. "We weren't established to make money. We're not here for the almighty dollar.

"Vets don't want low-cost clinics because it makes them lose money."

Arleda Brown of Jupiter takes her dog and two cats there. "I would never go back to a private veterinarian as long as (the clinic) is in town," she said.

The Jupiter clinic is financed by donations and gets some services from volunteers. That bothers local vets, who say they don't get those benefits and could never afford to charge such cheap rates.

"They're competing unfairly," said Mindy Cox, administrator of the Harmony Animal Hospital in Jupiter.

A statewide organization of veterinarians has "addressed state and federal authorities to try to get (the Jupiter clinic) out of its tax-exempt status," said H. Larry Gore, executive vice president of the Florida Veterinary Medical Association.

'Just no fairness'

"All we can do is appeal to government because there is just no fairness to the situation," he said. "They are absolved from paying taxes, but the vet has to."

Similar conflicts have pitted veterinarians against low-cost clinic operators throughout the nation for years. Vets in different parts of the country, including Michigan, Virginia and California, have asked their legislatures to ban the less expensive clinics. Most have failed.

Eight years ago, vets in Michigan organized statewide to put small, local clinics out of business by claiming the clinics were not operating in line with their tax-exempt status.

"The problem went to the Internal Revenue Service for interpretation and the IRS determined that the clinics were doing no wrong," said Sandy Rowland, the director of the Humane Society's four-state Great Lakes region.

In 1972, vets filed suit to close a city-run clinic in Los Angeles, arguing it competed unfairly against them. The vets lost the case.

In 1985, vets succeeded in closing a clinic in Virginia Beach, Va., under a law requiring such clinics be owned and operated by a licensed vet. The clinic has reopened and now contracts with a vet.

Vets may lobby Legislature

VMA reprentative Gore would not say whether Florida vets plan to lobby the Legislature to prohibit low-cost clinics from operating in the state.

"We are alert to the fact that they may try, and so we're anticipating it," said Marc Paulhus, director of the four-state Southeast region of the Humane Society.

The Indiantown Road clinic opened part-time in April and began daily business hours in September. It is staffed by licensed vet Balvir Khangura, veterinary technician Carol Clark and other volunteer staff members.

The clinic performed 800 sterilizations during the past six months, handling an average of six surgeries and 20 checkups a day.

Some local veterinarians say it would be easier to live side-by-side with the clinic if its director were willing to make some compromises about the services it offers and the people it offers them to.

"They're not only doing sterilizations there, but vaccinations, and that's taking away our bread and butter," Cox said. "And it's one thing that they could do for people who cannot afford it, but this clinic is open to everyone, regardless of need."

Clinic remains open to all

But Starling-Roca said she would not limit her services.

"We're not here to decide what animal deserves and what animal does not deserve to be treated," she said. "If low cost is what it takes to get an animal in, who am I to question it?"

When Orange County officials decided to open a low-cost clinic in Orlando, they compromised with local vets by offering sterilization services and rabies shots only. They also established a rebate system in which pet owners who chose to go to a private vet were reimbursed by the county the amount they would have spent at the clinic.

"There was vet opposition," said Don Westfall, department manager of Orange County Animal Control. "They're not totally happy about it, and that is why the compromise was necessary."

Business Coalition For
FAIR COMPETITION

April 13, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Pickle:

On behalf of the 40 national trade and membership organizations comprising the Business Coalition for Fair Competition (BCFC), I am submitting these comments regarding the recently issued "discussion options" on reform of the unrelated business income tax (UBIT).

You and your fellow Subcommittee Members are to be commended for the comprehensive review of the entire UBIT area and the thoroughness of your specific "discussion options." We sincerely appreciate the opportunity to work with you to modernize the UBIT regulations and root out the abuses that have unavoidably crept in over time as more and more tax-exempt organizations have entered the commercial arena by providing service and products for a fee to various publics.

At the outset, let me affirm that the manifold abuses resulting from unfair competitive activities by tax-exempt organizations, cutting across so many small business industries, that were described in multiple detail during your June 1987 five-day Subcommittee hearings, still continue. They should not be dismissed arbitrarily as episodic, exaggerated or extraordinary, as some leaders of tax-exempt entities contend. Rather, there continues to be a disproportional competitive impact from the commercial activities of tax-exempt organizations on small, tax-paying firms. The tax-exempt sector continues to gain marketshare, and often it is easier to document their gain, rather than the small business loss which often is highly localized, and frequently only can be measured by opportunity lost. While longer term economic damage data collection also is desirable, initial legislative reform of UBIT is urgently needed now.

Upon initial review of the UBIT "discussion options," BCFC stands in basic agreement with their thrust and encourages your Subcommittee to forward these options, after some limited fine-tuning, to the full Committee on Ways and Means for their consideration.

Here, then, are some specific comments from the BCFC regarding the "discussion options" (in so doing, we are following the basic outline in the March 31, 1988 Press Release):

"I." While generally we would support the outright repeal of the "substantially related" test, since there appears to be general agreement that it is nebulous and somewhat arbitrary, we endorse your specific "commerciality" test regarding activities "whose nature and scope are inherently commercial, rather than charitable." We agree that activities, conducted

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by tax-exempt organizations, that are similar to commercial for-profit enterprises, should bear the same tax as the for-profit enterprises.

Regarding "A" (gift shop/bookstore income), we suggest the inclusion of the specific example of the sale/rental of audiovisual materials and equipment.

Regarding "B" (sales or rental income of medical equipment and devices), we recommend that the exception for continuous-care outpatients be omitted, because of the past confusion that arose over the definition of a "patient" under the convenience exception. Also, excepting items not available in an immediate geographic area would unfairly create a barrier to future entry opportunities for small businesses.

Regarding "C" (income from certain health, fitness, exercise and similar activities), the suggested exclusion appears to maintain the present status quo. Rather, we would suggest that all income generated by these activities be taxed, unless it comes from the so-called "charitable class" of the unemployed, military, disadvantaged youth or senior citizens.

Regarding "F" (income from certain veterinary services), we recommend that the only exceptions be services performed on stray animals, those owned by indigent people, and services performed by teaching institutions to provide clinical education.

Regarding "L" (additional specified activities), we suggest, among others, that you recommend the application of UBIT to income from tax-exempt day-care centers since they compete directly with proprietary or tax-paying day-care providers.

We agree that both the "convenience exception" ("II"), and the "regularly carried on test" ("III") should be repealed since business or trade is commercial activity that should be taxed regardless of its recipients or frequency.

While we agree with the suggestions presented in "IV" and "V" regarding royalty income and the UBIT deductibility level, we suggest that a de minimis royalty test be instituted regarding excessive cooperative business ventures in the insurance area.

Under "VI" (debt-financed income), we suggest that whenever a tax-exempt organization solicits or receives donations, contributions, etc., it must specify that none of the funds will be used for unrelated business activity, and the donors should be so informed in writing. Should there be any violation of this, all sums should be returned to the donor immediately, with adjustments for tax penalties to make the donor whole.

We agree with "VII" and "VIII" regarding subsidiaries and joint ventures, and allocation rules. However, we suggest that the Subcommittee consider adding to the latter a requirement that cost-funding requirements, similar to those used to arrive at adjustments to expenses in the Medicare program (cf. Medicare form HCFA-2552-85) be used to allocate allowable expenses to offset commercial activity revenues. This accounting mode has been an accepted procedure by the Federal government for over 20 years.

Under "IX" (Tax Information Reporting/Internal Revenue Service Administration), we suggest adding a reporting requirement on the 990-T form that all revenues associated with support for non-exempt, commercial activity, including gifts, donations and investment income should be disclosed, thus subscribing to the accepted accounting principle of matching actual revenues to actual costs.

In addition, under "IX" we strongly urge the Subcommittee to adopt the recommendation of the Small Business Administration (SBA) that the IRS institute an expedited, administrative channel for the filing and review of complaints relating to the commercial activities of tax-exempt organizations. The protective spirit of UBIT and administrative efficiency of the IRS can be better served if the IRS has access to information targeting potential noncompliance with the law. Tax-paying small businesses are in the best position to identify potential violations of the law, but currently have no formal mechanism to do so.

Moreover, we strongly support the recommendation that the IRS (or GAO) undertake a comprehensive review of the multi-layered, corporate reorganizations that have taken place in the tax-exempt world, and the impact that "for-profit" subsidiaries of charitable organizations may have related to competition with small businesses. (See APPENDIX A: James J. McGovern, "The Use of Taxable Subsidiary Corporations by Public Charities -- a Tax Policy Issue for 1988," Tax Notes, Vol. 38 (March 7, 1988), pp. 1125-1131; and Malcolm Gladwell, "Companies Protest Hospitals' Move Into For-Profit Businesses," Washington Post (Washington Business, March 7, 1988).

Finally, we are in general agreement with the options in "X" (Miscellaneous), although we question whether it wise public policy to tax the passive investment income of tax exempt organizations, and support the recommendations of BCFC members regarding the modification of rules applicable to organizations that test for the public safety.

Mr. Chairman, we pledge to work with you and the Subcommittee Members to arrive at a just and equitable solution to the manifold abuses that have crept into the UBIT area. All of us are aware that the nature of the world has changed dramatically since the last major UBIT reform. You and your colleagues are to be commended for your forthright and timely initiatives to preserve the original intent of the UBIT legislation -- to safeguard tax-paying small businesses from the unfair competitive advantages of tax-exempt organizations.

Cordially,

Joseph F. O'Neil
Chairman

Enc.

APPENDIX A

SPECIAL REPORT

TAX ANALYSTS

THE USE OF TAXABLE SUBSIDIARY CORPORATIONS BY PUBLIC CHARITIES— A TAX POLICY ISSUE FOR 1988

by James J. McGovern

James J. McGovern is Director of the Employee Benefits and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service. The opinions expressed are those of the author and do not necessarily represent the views of the Internal Revenue Service. This article is based upon a paper prepared for the Independent Sector's 1988 Spring Research Forum.

In this special report, McGovern traces the historical development of the use of taxable subsidiaries by public charities as it relates to the issue of unfair competition between taxable and exempt entities. The report examines the statutory changes enacted to deal with the unfair competition question. McGovern then looks at the dramatic increase in the use of taxable subsidiary corporations by exempt entities during the 1980s. He concludes by discussing Congress' most recent review of the tax laws concerning the unrelated business activities of exempt entities, and recommends that an intensive look at the imposition of the section 4943 excess business holding rules on public charities is appropriate.

Table of Contents

I. Introduction 1125
II. The Early Years—The Debate Begins 1125
III. The Revenue Act of 1950—The Debate Continues 1126
IV. The Tax Reform Act of 1969— The Debate Continues 1127
V. The 1980s—Exempt Organizations Change— The Debate Intensifies 1128
VI. 1987—The Congressional Hearings 1129
VII. 1988 and Beyond—Will History Be Repeated? 1130

Disputes concerning the commercial activities of exempt organizations date to the beginning of the income tax. Such disputes have continued throughout the evolution of the tax laws. As a result of these disputes, Congress has twice focused upon exempt organizations' commercial activities and charges of "unfair competition," once in 1950 and again in 1969. Despite the years of controversy, Congress' efforts, and numerous court decisions, it now seems likely that this issue will once again be scrutinized in 1988.[1] One recurrent aspect of the debate has been the utilization of taxable subsidiary corporations by public charities. This subject is ripe for policy review in 1988 as the use of taxable subsidiaries has increased dramatically during the 1980s.[2] This article will trace the evolution of the use of taxable subsidiary corporations by public charities, and discuss the potential legislative reaction to their recent proliferation.

The Early Years—The Debate Begins

In 1913, the year in which the Sixteenth Amendment to the Constitution was ratified, giving Congress the "power to lay and collect taxes on income. . . ," a dispute arose between the Insular Collector of Internal Revenue of the Philippine Islands and a Philippine religious corporation over the commercial activities of that corporation.[3] The corporation derived its income from interest, rents, and dividends as well as from the sale of wines, chocolates, and other articles purchased and supplied for use in its churches and schools. The tax collector took the position that the corporation was not "operated exclusively" for religious purposes, but rather was operated, in part, for commercial purposes in that it used its properties to produce income, and traded in wines, chocolate, and other articles. This dispute was resolved in the organization's favor 11 years later. In *Trinidad v. Sagrada Orden de Predicadores*, the Supreme Court enunciated the "destination of income test," and held that the destination of the income—not its source—was the ultimate test of the right of exemption.[4]

During the next two decades the Internal Revenue Service (Service) was involved in similar disputes with charitable organizations that engaged in transparently profit-making activities. In one of the most celebrated cases, a corporation engaged in the manufacture and sale of macaroni was acquired and merged into a corporation organized to benefit the School of Law of New York University. The Service's assertion that this entity was neither organized nor operated exclusively for a charitable purpose was again thwarted by the destination of income test.[5] By the time the Third Circuit Court of Appeals rendered its opinion in that case, however, the law had been changed. Congress had already reacted to complaints that exempt organizations were engaged in profitable business activities in competition with taxable entities.

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[1] House Ways and Means Oversight Subcommittee Announces 1988 Agenda, Vol. 7, No. 55, p. 2611 (December 21, 1987).

[2] See, *infra*, ns. 22-23 and accompanying text.

[3] At that time the Philippine Islands were a territory of the United States.

[4] 263 US 578 (1924).

> [T]he involvement of educational institutions in the field of banking, real estate, commerce, and industry goes merrily on. Universities own haberdasheries, citrus groves, movies, cattle ranches, the Encyclopedia Brittanica (owned by the University of Chicago), and a large variety of other enterprises. The University of Wisconsin controls patent pools and collects royalties. Universities and colleges, together with foundations, have an annual income from their business activities of well over a half billion dollars annually. Were this income not tax-exempt, they would pay $173,000,000 in Federal taxes annually.[6]

The Revenue Act of 1950—The Debate Continues

The Revenue Act of 1950 devised a statutory framework intended to deal with the issue of unfair competition between taxable and exempt entities. The first part of the plan was the enactment of the "feeder" provisions of section 502 of the Internal Revenue Code to overturn the destination of income test (feeders are business organizations that "feed" income to a tax-exempt organization). Section 502(a) provides that an organization "operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501."[7] Congress noted that "such an organization is not itself carrying out an exempt purpose. Moreover, it is obviously in direct competition with other taxable businesses."[8]

The Revenue Act of 1950 devised a statutory framework intended to deal with the issue of unfair competition between taxable and exempt entities.

The second part of the plan to deal with the issue of unfair competition was the imposition of the regular corporate income tax on active business income arising from activities that are "unrelated" to an organization's tax-exempt purposes. This new "unrelated business income tax" was directed at unfair competition conducted by charitable organizations, labor organizations, and business leagues.

> The problem at which the tax on unrelated business income is directed is primarily that of unfair competition. The tax-free status of section [501] organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes. Also, a number of examples have arisen where these organizations have, in effect, used their tax exemptions to buy an ordinary business. That is, they have acquired the business with little or no investment on their own part and paid for it in installments out of subsequent earnings—a procedure which usually could not be followed if the business were taxable.
>
> In neither the House bill nor your committee's bill does this provision deny the exemption where the organizations are carrying on unrelated active business enterprises, nor require that they dispose of such businesses. Both provisions merely impose the same tax on income derived from an unrelated trade or business as is borne by their competitors.[9]

In devising this mechanism for dealing with unfair competition, Congress was specifically concerned with 'active' business income.

In devising this mechanism for dealing with unfair competition, Congress was specifically concerned with "active" business income. As such, it excluded from taxation the types of income that had traditionally been considered "passive" in nature, i.e., dividends, interest, royalties, and rents.[10] It soon became clear, however, that transactions could be structured to use these exclusions in conjunction with subsidiary corporations to avoid the unrelated business income tax.

Within months of the Revenue Act of 1950, for example, the Amon Carter Foundation formed a wholly owned subsidiary corporation and transferred to it certain oil and gas leases and related machinery. It was apparent that the new unrelated business income tax rules would subject the Foundation to taxation if it operated the business. Moreover, the destination of income test was no longer available to shield the subsidiary from taxation. Accordingly, the business operation was structured so that the new taxable subsidiary corporation operated the business, and paid "income" on the oil and gas properties to the Foundation in the form of overriding royalties. The Foundation claimed an exclusion from the unrelated business income tax rules on the basis of the "passive" nature of the royalty income. The Service objected, but was unsuccessful in its assertion that, in substance, the subsidiary corporation had no separate existence.[11]

In a similar case, the Robert A. Welch Foundation transferred a taxable "working interest" in oil and gas properties to its controlled taxable subsidiary corporations and subsequently reported income from these properties as nontaxable royalties. The Service asserted unsuccessfully in the Fifth Circuit Court of Appeals that the Foundation's income should be characterized, in substance, as a taxable 'working interest.'"[12] In a 1969 Revenue Ruling the Service announced that it would not follow the Fifth Circuit's opinion and that it would continue to review exempt organizations' transfers of mineral properties to controlled corporations and characterize the payments according to the substance of the transaction regardless of its form."[13]

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[5] *C.F. Mueller Co. v. Commissioner*, 190 F2d 120 (1951).

[6] Cong. Rec., Vol 96, Part 7, pp 9273-9274 (June 27, 1950).

[7] IRC sec. 502(a) (1986). Statutory references in this paper are to the Internal Revenue Code of 1986, as amended.

[8] H. R. Rep. No. 2319, 81st Cong., 2d Sess. at 41 (1950). S. Rep. No 2375, 81st Cong., 2d Sess. at 35 (1950).

[9] S. Rep. No. 2375, 81st Cong., 2d Sess. at 27 (1950).

[10] IRC sec. 512(b)(1) through 512(b)(3).

[11] *Amon G. Carter Foundation v. United States*, 58-1 USTC (CCH) 9342 (ND Tex 1958).

The Tax Reform Act of 1969—The Debate Continues

By the time the Service's 1969 Revenue Ruling was published, Congress was again responding to complaints of unfair competition between exempt and taxable entities. In this context there were two basic concerns. The first was the extensive involvement of private foundations—privately supported charitable organizations—in the business sector. Congress feared that charitable concerns had become secondary to business concerns. The Senate Finance Committee cited an example of one foundation that controlled 18 operating businesses, including a ten million dollar newspaper, the largest radio station in the state, a twenty million dollar insurance company, a lumber company, several banks, three large hotels, a garage, and a number of office buildings.[14] Congress reacted in the Tax Reform Act of 1969 by imposing severe limitations on the ability of private foundations to maintain holdings in business enterprises.

> Those who wished to use a foundation's stock holdings to acquire or retain business control in some cases were relatively unconcerned about producing income to be used by the foundation for charitable purposes. In fact, they might have become so interested in making a success of the business, or in meeting competition, that most of their attention and interest was devoted to this with the result that what was supposed to be their function, that of carrying on charitable, educational, etc., activities was neglected. Even when such a foundation attains a degree of independence from its major donor, there is a temptation for its managers to divert their interest to the maintenance and improvement of the business and away from their charitable duties. Where the charitable ownership predominates, the business may be run in a way which unfairly competes with other businesses whose owners must pay taxes on the income that they derive from the businesses. To deal with these problems, Congress concluded it is desirable to limit the extent to which a business may be controlled by a private foundation.[15]

New section 4943 prohibited private foundations, alone or in combination with disqualified persons, from owning substantial portions of any active business enterprise. Transition periods of up to twenty years were provided to allow for initial dispositions by foundations having substantial holdings in 1969, with an additional 15-year period provided before final disposition must be made. The penalty for owning business holdings in excess of the permitted amounts is an excise tax on the foundation.

Congress' second basic concern was that many of the other exempt organizations that were excepted from the unrelated business income rules (including churches) were engaging, or were apt to engage in, unrelated business. Congress responded by expanding the coverage of the unrelated business income tax to virtually all exempt organizations. In addition, there were changes limiting the types of income excepted from the unrelated provisions. One such provision was designed to prevent parent-subsidiary corporate transactions from escaping taxation through the use of sophisticated interest, rents, annuity, and royalty schemes. Specifically, section 512 (b)(13) was amended to provide a "controlled organization test," i.e., a test providing that in those situations where a tax-exempt organization owns more than 80 percent of a taxable subsidiary, the interests, annuities, royalties, and rents received by it from the subsidiary are to be treated as unrelated business income and are subject to tax in the hands of the exempt organization. This, of course, was a legislative response to those earlier cases where exempt organizations caused the profits of their controlled corporations to be passed on to them in the passive form, thereby avoiding the tax on the subsidiaries' income:

> In certain cases exempt organizations do not engage in business directly but do so through nominally taxable subsidiary corporations. In many such instances the subsidiary corporations pay interest, rents or royalties to the exempt parent in sufficient amount to eliminate their entire income, which interest, rents, and royalties are not taxed to the parent even though they may be derived from an active business.
>
> This problem is remedied under the bill by removing the exemption from the unrelated business tax for passive income if it is in the form of interest, rents, and royalties received from controlled corporations.[16]

Congress' second basic concern was that many of the other exempt organizations that were exempted from the unrelated business income rules (including churches) were engaging, or were apt to engage in, unrelated business.

This statutory change did not put the practice to rest. Indeed, two years after the 1969 amendment the Service assessed taxes against the Mabee Foundation. In that instance the Mabee Petroleum Corporation—a wholly owned taxable subsidiary corporation of the Mabee Foundation—engaged in the production and sale of oil and gas through ownership of oil and gas leases. The Foundation, as holder of the overriding royalty interests, received payments directly from the oil purchasers rather than indirectly through its subsidiary, which would have been the customary method of receiving such payments. The Foundation, while admitting that the subsidiary was a "controlled organization," argued that the overriding royalties should be excluded from unrelated business taxable income because the income was not "derived from" the subsidiary within the purview of section 512(b)(13) but rather from the oil purchasers directly. Neither the trial nor the appellate courts found this argument convincing. Indeed, the Tenth Circuit Court of Appeals described the method of payment as a "scheme . . . within the manipulations which Congress sought to tax:"

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[12] *United States v. Robert A. Welch Foundation*, 334 F2d 774 (5th Cir 1964).

[13] Rev. Rul. 69-162, 1969-1 C.B. 158.

[14] S. Rep. No. 91-552, 91st Cong., 2d Sess. at 39 (1969).

[15] Joint Committee on Internal Revenue Taxation, General Explanation of the Tax Reform Act of 1969, 91st Cong., 2d Sess. at 41 (1970).

[16] H.R. Rep. No. 91-413 (Part 1), 91st Cong., 1st Sess. at 49 (1969); S. Rep. No. 91-552, 1st Sess. at 73 (1969).

> It is of no consequence that Foundation and Petroleum had arranged for Foundation to receive the money directly rather than through Petroleum. Petroleum produces and markets the gas and oil to generate the production income upon which Foundation's overriding royalty income is based. Taxation does not depend on the mechanical formality of whether the overriding royalty income was paid through the controlled organization generating the income or directly to the charitable recipient. It appears clear beyond peradventure that Congress intended to tax a charitable organization's receipt of customary "royalties" from a "controlled organization."[17]

The 1980s—Exempt Organizations Change—The Debate Intensifies

The interest of exempt organizations in utilizing taxable subsidiary corporations increased significantly in the past decade. A decline in traditional funding sources and an increase in demand for services forced many exempt organizations into the commercial arena.[18] The Urban Institute's Nonprofit Sector Project, for example, found that Federal support for the nonprofit sector declined an estimated $4.5 billion between 1980 and 1984, and that this decline was offset in large part by commercial sources of income.[19]

The interest of exempt organizations in utilizing taxable subsidiary corporations increased significantly in the past decade.

Commentators began to take notice of the changed character of exempt organizations. One of the former Directors of the Urban Institute, for example, offered the following opinion on the findings of the Institute's Nonprofit Sector Project:

> As government support declines, private charity fails to fill the gap, and organizations turn increasingly towards commercial sources of income instead, the sector's willingness and ability to serve those in greatest need may decline, undermining the sector's raison d'etre in the process.[20]

This concern is remarkably similar to Congressional concerns about the business activities of private foundations prior to the Tax Reform Act of 1969.[21]

Another noted exempt organizations commentator, writing at approximately the same time, sounded the alarm:

> Subsidiaries and Subordinates. . . .
>
> Charities are not in the business of business: so may one "operate exclusively" for charitable purposes where it engages indirectly in activities through a subsidiary which it could not conduct directly? Since the regulations bar exemption to a charity which carries on an unrelated business as its primary purpose, should it be able to exalt two or more forms over one substance and bypass the regulations? While some former officials think otherwise, the government seems content to work the fringes in most cases rather than risk its regulations' integrity in inhospitable forums. And as nonprofits find out how profitable their exemption really is, in the practical marketplace, when it is exploited, the trend portends an administrative attitude challenging only the egregious overreachers, i.e., only kicking at the barking dogs.
>
> So for now, the quietly efficient, multi-tiered charitable enterprise, selling its related and unrelated goods, services, or facilities, to charitable classes of the public, to customers generally and to governmental units, does not see the Service as a threat to its integrity, but merely as an unruly, but manageable, partner. Congress seems unlikely to act on its own initiative, the Treasury Department seems unwilling to spend its meager resources in yet another study, and the public does not seem to sense that the magnitude threatens its peace and good order. The business community seems to be the only remaining interested party; and since it appears that the economy is sufficiently expansive to be hospitable to all newcomers, regardless of cloak or mantle, that community seems content to absorb or accommodate its charitable competitors.[22]

To survive in a dramatically changing economy, many section 501(c)(3) organizations began to revise their corporate structures. The increased use of taxable subsidiary corporations was a part of this strategy. For example, the Service issued 593 private letter rulings to section 501(c)(3) organizations that operated in tandem with taxable subsidiary corporations between 1977 and 1986. In comparison, there were only 8 equivalent rulings issued in the previous ten year period.[23]

This change was most notable in the health care sector as 435 of the 593 rulings involved health care organizations.[24] Nonprofit community hospitals particularly felt the brunt of a changing economy. Government, business, and third-party payors sought to control health care costs that had escalated wildly in past years of high inflation and double digit interest rates. In addition, the Federal government moved away from a cost reimbursement system under the Medicare program to a prospective payment system based on pre-set prices. As this financial reimbursement system was changing, nonprofit hospitals were faced with competition for patients and doctors from chains of aggressive for-profit corporations. In order to survive in a changing, heavily regulated, and intensely competitive environment, nonprofit hospitals began to diversify by reorganizing into multi-entity structures. In most instances, a taxable subsidiary corporation was included in the new system.[25]

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[17] *The J.E. and L.E. Mabee Foundation v. United States*, 533 F 2d 521 at 524 (10th Cir. 1976).

[18] McGovern, "The Changing Character of Exempt Organizations," 19 Phil. Monthly 19 (1986).

[19] Salomon, "The Results are Coming In," 25 Found. News 16, 17 (1984).

[20] *Id.* at 23.

[21] *See, supra*, n. 15.

[22] Lehrfeld, "Dealing with Investors and Other Methods of Generating Income: Tax Aspects of Revenue Producing Activities," 42 Inst. of Fed. Tax'n 26-1 (1984).

[23] These statistics are based upon an automated search of a private ruling letter data base.

[24] *Id.*

Subsidiary corporations are used in the multi-entity systems to structure transactions so that income flowing between the corporations can be characterized as nontaxable passive income.

Subsidiary corporations are used in the multi-entity systems to structure transactions so that income flowing between the corporations can be characterized as nontaxable passive income. In the early 1980s, for example, the District Director in Detroit sought advice from the IRS' National Office about a parent-subsidiary corporate transaction involving a hospital system that sought to escape the unrelated business income tax through the use of a sophisticated rent arrangement similar to the one used in the Mabee Foundation case. The transaction involved a tax-exempt parent holding company that controlled two wholly owned subsidiaries: a tax-exempt hospital and a for-profit pharmacy and optical shop. The hospital leased space in its facility to the for-profit pharmacy and optical shop. Rental payments from the for-profit entity were made to the tax-exempt hospital and not to the parent corporation. As the hospital did not control the for-profit subsidiary, the parent corporation claimed that the rent payments to the hospital were not subject to section 512(b)(13) or the unrelated business income tax. As in the Mabee Foundation case, this scheme was an attempt to structure the transaction so that typically "passive" income payments are received from third parties rather than from the exempt organization's controlled corporation. It was the opinion of the IRS' Office of Chief Counsel, however, that the interposition of a wholly owned entity between the exempt controlling organization and the wholly owned source of the payments may be disregarded for purposes of applying the unrelated business income tax. Accordingly, rent payments to the hospital were deemed subject to section 512(b)(13) and the unrelated business income tax.[26]

It should be noted that the statistics involving the use of taxable subsidiary corporations by nonprofit hospitals are available primarily because these institutions reorganized and evolved from a single entity into a system of entities. Under these circumstances nonprofit hospitals could no longer rely on the ruling letters recognizing their exempt status. Accordingly, most sought approval from the Service through the rulings process, and advised that their reorganization involved one or more taxable subsidiary corporations. But for these major structural changes, the Service may not have been apprised of the scope of the use of taxable subsidiary corporations. While section 6033 requires most public charities to file an information return that is available to the public, there is no equivalent authority to require the disclosure of returns of taxable subsidiary corporations. It is this author's opinion, however, that there is widespread use of taxable subsidiary corporations throughout the public charity sector. Indeed, there are indications that multi-entity systems are being analyzed by the university community.[27]

1987—Congressional Hearings

On September 12, 1986, the House Ways and Means Committee announced a hearing to review the Federal tax treatment of commercial and other income-producing activities of tax exempt organizations and related entities.[28] Five days of hearings were held in June 1987. The Deputy Assistant Secretary (Tax Policy) of the Treasury Department presented the government's policy views on the appropriate tax treatment of income-producing activities of exempt organizations and related entities.[29] Due to a lack of data in this area, Treasury did not offer specific legislative proposals, but rather offered recommendations and suggestions as a starting point for further debate. This testimony, which was comprehensive in scope, made two recommendations for revision of the tax laws that pertain to the use of taxable subsidiary corporations.

While section 6033 requires most public charities to file an information return that is available to the public, there is no equivalent authority to require the disclosure of returns of taxable subsidiary corporations.

The first recommendation was to revise the controlled organization test of section 512(b)(13). Treasury noted that an exempt organization could own 100 percent of the voting stock of a subsidiary, 99 percent of the total value of a subsidiary, but only 79 percent of a single class of nonvoting stock, and not technically fall within the definition of a controlled organization. Treasury's recommendation was that the definition of a controlled organization should be changed to include an organization in which the parent exempt organization has more than a 50 percent interest, measured by either voting power or value. In addition, Treasury suggested that application of the ownership attribution rules be enacted so that a subsidiary controlled by an affiliate of an exempt organization would be covered.

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[25] McGovern, "Restructured Nonprofit Hospitals," 35 *Tax Notes* 405 (1987, No.4).

[26] GCM 38878, July 16, 1982. A GCM (General Counsel Memorandum) is a legal opinion of the Office of Chief Counsel that is based upon the particular issues and facts of a specific case. GCMs are not intended for precedential use, and do not represent the official agency position.

[27] See, e.g., *LTR 8637089* (June 17, 1986).

[28] Committee on Ways and Means, U.S. House of Representatives, Press Release #25, (September 12, 1986).

[29] Statement of Hon. O. Donaldson Chapoton, Depty Asst Secy (Tax Policy), Dept of the Treas., Before the Subcommittee on Oversight of the Committee on Ways and Means.

Treasury also suggested that consideration be given to aggregating the activities of an exempt organization and its subsidiaries.

Treasury also suggested that consideration be given to aggregating the activities of an exempt organization and its subsidiaries. Under present law, a section 501(c)(3) organization can engage in a business as a substantial part of its activities so long as the operation of the business is in furtherance of its exempt purpose and it is not organized or operated for the "primary purpose" of carrying on an unrelated business. Treasury recommended that, in appropriate cases, the activities of an exempt parent and its subsidiaries should be aggregated to test for the exempt organization's primary purpose (especially where management of the subsidiary is fully integrated with that of its parent).

These recommendations were subsequently endorsed in an October 15, 1987, letter to the Chairman of the House Ways and Means Subcommittee on Oversight from four Republican members of that Subcommittee.[30] As such, they are likely to receive serious consideration by the full Ways and Means Committee in 1988.

1988 and Beyond—Will History Be Repeated?

In 1950, Congress attempted to create rules that would prevent exempt organizations and their subsidiaries from competing unfairly with taxable businesses. Nineteen years later, in 1969, Congress recognized that the problem had not been solved by its 1950 legislation and created additional rules to restrict exempt organizations' use of taxable subsidiaries. Now, once again nineteen years later, Congress may find it necessary to enact yet more legislation attempting to prevent exempt organizations from using taxable subsidiaries to compete unfairly with other taxable businesses. Certainly, Congress' current concerns in this area are nearly identical to the concerns that Congress expressed in this area prior to enacting legislation in *both* 1950 *and* 1969.

Perhaps, then, the basic issue to be considered as Congress ventures into its third major review of the tax laws dealing with the issue of unrelated business income and unfair competition, is whether perceived abuses can be dealt with through continued piecemeal revisions to a very complex tax law. Previous Congressional responses have not been successful in dealing with this situation. If history is a guide, the suggested revision to the controlled organization test of section 512(b)(13) may prove, once again, to be only a temporary obstacle to those seeking to characterize income as passive (i.e., nontaxable) in nature. Indeed, some practitioners have already offered opinions to this author that the proposed commercial activity aggregation rules will not be effective in dealing with hospital systems. They note that the difficulty of aggregating the activities of hospitals and their subsidiaries is that the gross income of hospitals is larger than that of most other public charities.[31] As such, hospitals will be able to aggregate a significant amount of subsidiary business activity without failing a "primary purpose" test.

If perceived abuses cannot be effectively addressed through microscopic revisions of a very comprehensive tax law, the alternative is macro change. In looking for an effective change of this magnitude, the obvious model is the section 4943 excess business holding rules imposed on private foundations in the Tax Reform Act of 1969. These excise taxes were not only specifically designed to deal with business involvement of privately funded section 501(c)(3) organizations, but also were subsequently found to be effective limitations on the problem of the ownership of active business enterprises by private foundations. In June of 1983 the Subcommittee on Oversight of the House Ways and Means Committee conducted hearings to examine the effectiveness of the rules governing private foundations. The hearings were prompted by bills that were introduced into the previous session of Congress to modify various private foundation rules, including the rules that limit private foundation business holdings. In testimony before the Subcommittee, the Treasury Department opposed elimination of the restrictions on excess business holdings. Treasury testified that the possibilities for conferring private benefit through a controlled business were both numerous and in many cases very subtle. Treasury thus opposed any changes in the basic excess business holding rules except for a change to allow, under limited circumstances, an additional five year period for disposition of post-1969 excess business holdings.[32] This position was also the independent recommendation of the Council on Foundations and the National Committee for Responsive Philanthropy.[33]

The suggested imposition of the excess business holding rules on public charities has both economic and tax policy consequences. From the economic perspective, this suggestion should be scrutinized with caution. To begin with, there is a lack of data about the extent of commercial activity of exempt organizations.[34] It is clear that Federal support for the exempt sector has declined dramatically in recent years and that sophisticated exempt organizations have entered the commercial arena in response to this decline. It is unclear whether the first priority of these organizations is the bottom line or the provision of charitable services. Historically, the major initiatives in addressing significant issues of medical care, housing, education, and employment have emanated from the charitable sector. If the economic base of today's exempt organization is dramatically slashed without considering ways to continue these contributions, major difficulties may arise in the provision of social services in the future, particularly during a recession or when the business economics of the marketplace are otherwise unfavorable.

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[30] Ways and Means Oversight Subcommittee Republicans Submit Recommended Modification of UBIT, dated October 15, 1987, Daily Tax Highlights & Documents, Volume 7, Number 20, p. 1044 (October 29, 1987).

[31] IRS Statistics of Income Bulletin, Winter 1985-86, p. 26.

[32] Tax Rules Governing Private Foundations: Hearings Before the Subcomm. on Oversight of the Comm. on Ways & Means of the House of Representatives, 98th Cong., 1st Sess. 33-51 (1983) (statement of Hon. John E. Chapoton, Asst Secy (Tax Policy), Dept of the Treas.).

[33] *Id.*, at 151 and 205.

[34] Despite a comprehensive search, the General Accounting Office could not find such data. GAO examined the IRS' Statistics of Income and Exempt Organizations Business Master File data bases. In addition, GAO examined studies by the Bureau of Census in 1977 and 1982, the Urban Institute in 1982, the Partners for Livable Places and the Rockefeller Brothers Fund in 1982, the Independent Sector in 1984, the Small Business Administration in 1984, and the National Assembly of Voluntary Health and Welfare Organizations in 1985. GAO/GGD-87-4OBR.

From the tax policy perspective, a continued proliferation of taxable subsidiary corporations by public charities is of equal concern. As noted at the beginning of this article, one of the objectives of the unrelated business income tax was to prevent unfair competition and impose the same tax on income derived from unrelated business concerns as is borne by taxable entities.[35] As this article has demonstrated, however, public charities have, over the years, used creative tax planning to cause the profits of their controlled corporations to be passed on to them in passive form, thereby avoiding the tax on the subsidiaries' income. As this article also has demonstrated, previous Congressional responses have not been successful in resolving this concern. What is different in 1988 is that the use of taxable subsidiary corporations has spread prolifically throughout the public charity sector. Under these circumstances, it is this author's opinion that an intensive look at the imposition of the section 4943 excess business holding rules on public charities is appropriate.

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[35] *See, supra,* n. 9.

CURRENT AND QUOTABLE

Grandy Says Delay in Forms Necessitates Delay For Farmers' Filing Deadline

Set forth below is the full text of a February 16, 1988 letter to Treasury Secretary James A. Baker III from Rep. Fred Grandy, R-Iowa. The letter also has been placed in the March 7, 1988 Tax Notes Microfiche Database as Doc 88-1964.

Dear Mr. Secretary:

It is with great urgency that I bring to your attention a problem that is causing distress to farmers throughout the nation. The unfortunate situation which has appeared is in regards to the March 1 filing deadline for farmers' tax forms.

The problem centers around the Agriculture Stabilization and Conservation Service (ASCS) CCC-182 and additional 1099-A tax forms, which farmers use in filing their tax returns. Due to the delay in distribution of these forms, many farmers will have a quandary in meeting the March 1 deadline. At the time of this communication, there are many farmers who are still awaiting the arrival of the CCC-182 and 1099-A forms.

In addition, many local ASCS offices admitted finding errors in these forms. Because of the complications with these forms, there has been an undue liability placed on American farmers. As you can imagine, the Treasury will soon be hampered by complaints associated with this issue.

In order to avoid unnecessary errors and additional hardships on the farmer and the Treasury, I request a two-week delay in the filing deadline for farmers.

Sincerely,

Fred Grandy
Member of Congress

CURRENT AND QUOTABLE

Apolinsky Calls for Ten-Year Moratorium on Tax Legislation

Set forth below is the full text of a February 11, 1988 letter to Assistant Treasury Secretary O. Donaldson Chapoton from Harold I. Apolinsky of Sirote, Permutt, McDermott, Slepian, Friend, Friedman, Held & Apolinsky, P.C., Birmingham, Ala. The letter also has been placed in the March 7, 1988 Tax Notes Microfiche Database as Doc 88-1967.

Dear Don:

A "small" tax bill is an oxymoron, similar to postal service or military intelligence. What we need is a 10-year moratorium that will give your guys an opportunity to finish regulation projects. Without regulations, you know we in the tax field take the most aggressive positions.

Enclosed is a memorandum we discussed at our Commissioner's Advisory Group meeting in December. It brought into perspective the adverse effect on compliance and quality from frequent changes in the tax laws. We are now up to eight tax bills in the last 11 years.

As the highest level government official in charge of tax policy, please consider urging a moratorium.

Yours very truly,

Harold I. Apolinsky

Washington Business, March 7, 1988

Companies Protest Hospitals' Move Into For-Profit Businesses

By Malcolm Gladwell
Washington Post Staff Writer

Three years ago, Irving Swartz had a thriving medical equipment business in Alexandria. Local hospitals would refer patients to him, and he would sell or rent them everything from wheelchairs to oxygen tanks—all the medical equipment they would need to continuing receive medical treatment at home.

But now Swartz is out of the business, driven out illegally, he alleges, when Arlington Hospital, Fairfax Hospital System and Alexandria Hospital banded together and went into the medical equipment business themselves.

Last month, Swartz filed an antitrust lawsuit against the three hospitals and their equipment subsidiary—Home Health Equipment Co.—in a federal court in Virginia, asking for $2 million in damages and a court order breaking up the company.

Home Health dismisses the suit as meritless. But Swartz is being cheered on by small companies in health-care fields around the nation that have been complaining for years about the diversification of hospitals into their for-profit markets. Nonprofit hospitals, they say, have used tax-exempt status, size and control over patients to diversify into for-profit businesses and unfairly compete against the smaller companies.

The issue is especially heated in Virginia, where the General Assembly recently completed an investigation into the practice and last week passed two bills aimed specifically at regulating hospital diversification. The bills' backers say they hope the legislation is the first step in eventually banishing hospitals from businesses like health equipment.

"Nonprofit hospitals were established and given nonprofit status because they fulfilled a need which otherwise could only have been done by government," said Virginia Del. Harry Morgan (R-Gloucester), chairman of the joint investigating committee that sponsored last week's bills.

"As long as they fill that mission, we certainly want to support them. But when they get into other activities and use all their advantages against other people, that's where we have to draw the line. . . . Good people are being forced out of business," Morgan said.

The Arlington, Fairfax and Alexandria hospitals formed Home Health Equipment Co., a for-profit company with revenue last year of $3.7 million, in January 1986 to capitalize on the growing market for at-home care.

"These days, you've got to be a full-service provider," said Donald L. Harris, executive vice president of Fairfax Hospital's parent company, Inova Health Systems, explaining the venture. "It was a recognition by all three of us that together we could provide an alternative source of medical equipment to patients coming through our hospitals."

The joint effort follows a national trend that has seen nonprofit hospitals over the past 10 years increasingly look outside their own walls for new sources of revenue to subsidize their traditional health-care services.

As changes in government regulations and cost-cutting efforts by the private sector have reduced the demand for hospital services, hospitals across the country have bought nursing homes, outpatient services, health clinics, and even some businesses entirely unrelated to health care.

Some of the new ventures are organized under a hospital's existing nonprofit umbrella. But many, because of Internal Revenue Service regulations that prohibit nonprofit involvement in certain competitive markets, are set up as separate tax-paying entities linked to the hospital system by a parent foundation.

Arlington Hospital Foundation, for instance, also runs an answering and paging service. Alexandria's parent foundation operates two for-profit fitness centers, the Skyline Physical Therapy Center and the Human Performance Center. And Fairfax Hospital System has no less than 12 for-profit enterprises under the umbrella of Inova Health Systems, which last year generated $35 million of the Fairfax system's $425 million in revenue.

"There is a continuing expectation that nonprofit hospitals engage in behavior that doesn't bring in a profit, like charitable care, and ed
cational and community work," said Bradfor
Gray, senior professional associate at the N
tional Academy of Science's Institute of Med
cine. "But it costs money to do that, and pa
ers have begun to ratchet down on the amou
they're willing to pay to hospitals."

For-profit businesses, he said, echoing th
argument that is made by hospital administr
tors around the country, are now an importa
ingredient in helping nonprofit hospitals f
nance their operations, particularly charitab
care for patients who can't pay regular fees.

But for many critics, the distance betwee
the nonprofit and for-profit activities of man
hospitals isn't wide enough.

A report on nonprofit activities released la
month by Morgan's investigating subcommi
tee in Virginia listed five major complaints o
small businesses against nonprofits, all cen
tered on the charge that the tax-exempt statu
of nonprofit hospitals gives them a unfair ad
vantage when it comes to involvement in com
petitive markets.

For example, the report said many business
es feel that for-profit subsidiaries of hospital
get unfair access to a huge pool of untaxe
venture capital generated by the hospitals
Then there's the "halo effect" a nonprofit ca
receive through its tax-exempt status, commu
nity support, volunteer labor, free advertising
donations and other services that benefit
charitable image.

PHOTO BY ELLSWORTH J. DAVIS—THE WASHINGTON POST

Irving Swartz has sued three hospitals, claiming their for-profit subsidiary ruined his business.

But perhaps the most common complaint against hospitals centers on what is known as "captive referral," the practice of nonprofit hospitals steering patients only toward outpatient and ancillary health services that they own.

Last week, the Virginia General Assembly passed legislation that its backers hope will begin to curb that practice, which critics say ultimately could increase the cost of medical services by driving out independent competitors. The legislation requires doctors to declare to their patients the existence of alternative outpatient services or facilities when they make a referral.

Captive referral is also at the center of Swartz's suit against Home Health Equipment. The suit alleges that the three hospitals "collectively and collusively determined that all patients in their hospitals requiring outpatient health equipment would be referred only to [Home Health Equipment Co.] . . . and that further referrals through the defendant hospitals to other companies in competition with Home, such as [Swartz' business] would be terminated or severely curtailed."

According to Swartz's attorney, Jerry W. Boykin, Alexandria Medical Art's equipment business fell from $1.1 million in 1984 to less than half that in 1986 after Home Health entered the Northern Virginia market.

One doctor who gave Swartz 38 patient referrals in 1984 gave him none in 1986, said Boykin, who alleges that officials of the three hospitals denied physician requests to refer patients to Swartz's business and offered cash incentives for exclusive use of Home Health. By 1986, Boykin says, Swartz' business was dead, and he sold the assets "for practically nothing" to a foundation associated with Washington's Greater Southeast Community Hospital. Swartz now runs a pharmacy in Alexandria.

Home Health's lawyer, Philip A. Proger, declined to comment on the charges, dismissing them as frivolous. But officials of the three hospitals are known to dispute the allegations of collusion, as well as the charge that the formation of Home Health led to a monopoly in Northern Virginia.

"We don't apologize for Home Health at all," said Inova's Harris. "We think it's a real advantage to provide patients with that alternative."

There are, however, many other businesses that claim similar injury from captive referrals, and some officials in the health-care field predict that the Swartz suit will be the first in a flood of legal actions.

"This is health care insider trading," said Tom Inam, who runs a medical equipment business in Newport News. "It's going on all over the country." ■

COMMENTS ON BEHALF OF BUTTERWORTH HEALTH CORPORATION ABOUT DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

These comments are being submitted in response to Press Release #16, Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives, dated March 31, 1988, which requested public comments on the discussion options relating to unrelated business income tax. They are submitted on behalf of Butterworth Health Corporation of Grand Rapids, Michigan ("Butterworth"), by its attorneys Dykema Gossett.

I. Description of Butterworth. In order to understand the concerns of Butterworth about the issues raised in the discussion options, it may be helpful to describe the organization and its activities briefly. Butterworth is a health care holding company which has been determined to be tax exempt under Section 501(c)(3) of the Internal Revenue Code of 1986 (the "Code"). It currently has four subsidiaries which are also tax exempt under Section 501(c)(3) of the Code: (i) Butterworth Hospital, which operates a 529 bed general hospital in Grand Rapids, Michigan; (ii) Grand Valley Nursing Centre, which operates a 165 bed skilled nursing facility also located in Grand Rapids; (iii) Butterworth Aero Med, Inc., which provides medical transport helicopter services in Western Michigan; and (iv) Butterworth Foundation, which holds endowments and raises funds on behalf of the other Section 501(c)(3) organizations. Butterworth also controls Butterworth Health Plan, Inc., a health maintenance organization which is exempt under Section 501(c)(4) of the Code and owns all of the stock of a taxable business corporation known as Butterworth Ventures, Inc. Butterworth Ventures owns a group of taxable subsidiaries which provide ambulatory medical care, sell durable medical equipment and own retail pharmacies. A minority interest in some of these subsidiaries is held by another tax exempt hospital. While approximately 15% of the expenses of the Butterworth group during the last half of 1987 were incurred by organizations which are not exempt under Section 501(c)(3), virtually all of the activities of the group related directly to the provision of some form of health care services. Because of its commitment to providing health services in Western Michigan, Butterworth is particularly concerned about changes in the Code which would affect the taxation of revenues from medical services.

II. General Comments. Health care is a matter of vital concern to individual Americans. Since health care expenditures also represent a major cost of doing business for U. S. employers and a significant portion of the budgets of federal and state government, tax policy should encourage the efficient delivery of quality health care services and, in furtherance of that goal, should promote rather than inhibit fair competition among taxable and tax exempt providers.

The traditional pattern for the delivery of health services in the U. S. has been for inpatient services to be provided in tax exempt community hospitals while services for ambulatory patients were furnished in the offices of private physicians. The increasing complexity of medical technology and an awareness of the need to minimize cost have changed this pattern significantly. These circumstances have led to the development of a variety of new types of facilities and services, including programs to provide nursing care and medical equipment in the home, outpatient surgery facilities and ambulatory care centers which have the capacity to perform sophisticated procedures for the diagnosis and treatment of illness and injury. In addition, some health maintenance organizations and other payors for services are seeking to control costs by encouraging health screening and educational programs designed to reduce health risks.

The health care industry is unique in the degree to which services are provided by both tax exempt institutions and taxable entities. In allowing individuals to deduct medical expenses, Section 213 of the Code recognizes a broad range of medical services as constituting legitimate deductions. These include most inpatient hospital services, physicians' fees, nursing care, medical testing and equipment and prescription drugs, Reg. §1.213-1(e). There is probably no deductible medical service which is not furnished by both tax exempt and proprietary providers. As a result, the idea that some activities are "inherently commercial" is peculiarly inappropriate when applied to medical care.

The principal reason why Section 511 of the Code imposes "unrelated business income tax" ("UBIT") on certain income of exempt organizations is to prevent such organizations from gaining a competitive advantage over commercial enterprises in the same line of business. Under current law, the types of services which have been traditionally provided predominantly by tax exempt organizations, such as inpatient hospital care, have not been subject to UBIT, notwithstanding that these activities may compete with proprietary hospitals. The IRS currently assesses UBIT with respect to activities which have traditionally been provided by taxable entities, however, such as the sale of prescription drugs and laboratory services to persons who are not hospital patients.

Any amendments to the Code which would extend UBIT to income from medical services which are not currently taxed will directly affect the costs associated with those services, a result which is inconsistent with the need to minimize health care costs. Of even greater concern, however, is the effect some of the proposals under consideration will have on the ability of exempt organizations to provide a full range of services in the most efficient manner.

Butterworth and its Section 501(c)(3) subsidiaries have no alternative to retaining their exempt status. Among the many reasons why exemption is essential is the continuing need of the organizations for tax deductible donations. Also, Butterworth Hospital used tax exempt bond financing for the construction of some of its facilities and loss of exempt status would constitute a default under the agreements governing the bonds.

One of the fundamental requirements for tax exempt status under Section 501(c)(3) of the Code is that the "primary activities" of the organization be ones considered to be charitable, Reg. §1.501(c)(3)-1(c)(1). Activities subject to UBIT are allowed as long as they do not constitute the "primary purpose" of the organization, Reg. §1.501(c)(3)-1(e)(2). No precise guidelines exist under current law as to how the "primary purpose" of an organization is measured and tax professionals differ widely in their advice on the amount of taxable activity which can be conducted by an exempt organization without jeopardizing its exemption. Because the retention of tax exempt status is so important for most institutions, their boards and managers are often hesitant to engage in activities which are taxable, either out of a sense that the activity may be "inappropriate" for the organizations or from a fear, which may often be unwarranted, that even limited activity might result in loss of exemption.

In encouraging Congress to enact legislation extending UBIT, some proprietary health care providers may be more interested in discouraging tax exempt organizations from entering certain segments of the health care market than they are in assuring equal competition within those markets. Sound economic and health policy, however, requires that the tax laws encourage exempt health care institutions to provide a full range of medical services, particularly the preventive and ambulatory services which provide a lower cost alternative to inpatient hospital care. Where considerations of promoting equal competition dictate that some activities be subject to tax, the tax laws should provide a way for exempt organizations to be able to engage in those activities, subject to substantially the same tax rules as are applicable to their commercial competitors, without risking their exemption.

III. Comments on Particular Options:

A. Repeal of the "Substantially Related" Test. The suggestion that the current rule under Section 513 which exempts from UBIT revenues derived from activities which are "substantially related" to the achievement of the organization's exempt purpose be repealed and that language be substituted which would exempt only activities "directly related" to the organization's charitable purposes would only add confusion to a part of the tax law which already lacks clarity. It is currently not possible to deduce what activities the IRS considers to be taxable solely from a logical analysis of how "related" they are. Considerations of public policy, competition and custom also play a significant role in determining what is taxable. For example, it is unlikely that a person unfamiliar with current law would conclude that sale of pharmaceuticals by a hospital might in some cases be taxable but that the sale of broadcast rights to a football game are "substantially related" to the educational functions of a university. Many of the concerns which exist about compliance with UBIT arise from uncertainty as to what is and what is not taxable. Changes in the language which do not clearly delineate the activities subject to tax are likely to make good faith efforts at compliance even more difficult than they are at this time.

B. Determining "Whether Each Income Producing Activity Standing Alone is Tax Exempt." The suggestion that each "income producing activity" of an exempt organization must be "tax exempt" in order to avoid income from that activity being subject to UBIT again introduces additional confusion into the law. Part of the uncertainty arises from the fact that no definite standard is set forth for making this decision. In the case of health care services, there may also be considerable difficulty in determining what are and what are not "income producing" activities. While hospitals typically maintain a schedule of charges for particular services these frequently bear little relationship to what they are actually paid for their services. In the vast majority of cases, the payment amount is determined under the rules of Medicare, Blue Cross and other payors. The trend is for payors to provide a single payment which covers a wide range of individual services. The principal reason for adopting a particular method of payment is that it provides incentives for health care providers to use the least expensive treatment alternative available. The most prominent example of this approach is the Medicare prospective payment system which in most cases now provides a single amount computed on the patient's "diagnosis related group" or "DRG" which is intended to reimburse a hospital for all of the many operating costs which arise from the hospitalization of a patient. Also, HMOs and other payors frequently pay for medical services on the basis of a fixed amount per subscriber per month, whether or not a particular subscriber actually uses any services that month or not. As long as the total amount of the payment is treated as being for "hospitalization" or "medical care," the payment is likely to be considered to be exempt. If, one the other hand, an attempt is made to assign the amount received to any of the particular services which may have been rendered, for example, to determine how much is being paid for a particular lab test, x-ray or haircut, it becomes necessary to develop a methodology for deciding which of the many elements of the services being provided will be considered to be "income producing" and how actual revenues received will be allocated to those services. Developing an equitable method for doing so is an enormously complex task and tends to defeat the legitimate policy reasons which led the payors to provide a single payment in the first instance.

C. Imposition of UBIT on Specific "Inherently Commercial" Activities.

1. Gift Shops. From the press release and other materials available with respect to the options under consideration, it appears that it is not contemplated that most of the items sold in a typical hospital gift shop will be subject to tax. It makes little sense, however, for the IRS to be auditing the contents of hospital gift shops to determine whether all of the items sold are those "generally used by or for inpatients." If provisions are enacted to tax certain sales from museum gift shops, it would be preferable for there to be a general exemption for gift shops located on the premises of hospitals.

2. Medical Equipment, Laboratory Testing and Pharmaceutical Sales. It is not completely clear from the description of this option what changes are being proposed in the current law. Sales of medical equipment, laboratory testing and prescription drugs to persons who are not patients are generally being taxed under current law and, in fact, most of the services of that type currently being provided by the Butterworth group of companies are being performed by taxable corporations. The principal change suggested is apparently to tax sales to outpatients who "do not require continuous care or treatment." The administration of drugs and the performance of laboratory tests are an integral part of health care services provided to persons receiving outpatient services from exempt organizations. Taxing such services represents a significant

change in the law and, as described above, one which is seriously at variance with previously articulated federal policy designed to encourage such organizations to provide care in the least costly setting available. Current practices for determining payment for such services would, in many cases, make it extremely difficult to ascertain the income derived from these activities.

3. Applying UBIT to All "Routine Testing." Taken at face value, this proposal would subject virtually all pathology services performed by exempt organizations other than pre-surgical testing and services performed in connection with educational programs to UBIT. While it can be questioned whether a change in the law this extensive is actually being given serious consideration, it should be noted that such a change would impose tax on an activity which was previously considered to be an integral and essential part of the health care services provided by exempt organizations, including many services funded by the federal government. In addition to taxing laboratory services, such a rule could also be interpreted to impose tax on a wide variety of other health care services designed to provide for the early detection of medical problems, including physicals, well baby exams and mammograms. Such changes are clearly inconsistent with health care policies designed to reduce costs by encouraging the prevention and early treatment of illness. Again, in many instances, ascertaining the amount of income attributable to such activities will be difficult.

D. Repeal of the "Regularly Carried On" Test. The "regularly carried on" test is applied most frequently to distinguish activities such as auctions or candy sales which exempt organizations conduct sporadically as "fund raisers" from the continuous conduct of comparable businesses. A repeal of this provision may lead to uncertainty as to the appropriate treatment of a variety of other transactions. For example, the frequent sale of real estate or securities may result in an individual being classified as a "dealer" rather than an investor, something which may have consequences for both tax and other regulatory purposes. Repealing the "regularly carried on rule" might, therefore, allow the IRS to claim that sales of donated property or investments or other business transactions on the part of exempt organizations which would have a commercial character if conducted repeatedly are taxable as a "trade or business."

E. Taxation of Royalty Income. The proposal that royalty income resulting from property created, developed or marketed by exempt organizations be subject to UBIT is another radical change in the current law. The example given in the description of the discussion options of taxing royalty income from the licensing of university logos and cartoon characters to a sweat shirt manufacturer is a rather frivolous example of the effect of such a change. Such a rule would go well beyond that example and would impose UBIT on the revenues derived from the intellectual property developed by exempt organizations, including royalties derived by hospitals and universities from the licensing of copyrights and patents developed in the course of medical, scientific and academic research. These can be important sources of revenue for the support of research; and, the possibility that an organization could lose its exemption as the result of income from research activities could inhibit valuable medical advances and threaten American technological development.

F. Taxing Income of Taxable Subsidiaries as If It Were UBIT. The calculation of unrelated taxable income is subject to some rather obscure rules which are different from the comparable rules applicable to taxable organizations. One such rule provides that if an organization is engaged in two lines of business generating unrelated business income, it cannot offset losses from one activity against gains from another. If, on the other hand, a commercial competitor conducts the same two activities, its tax will be computed only on the combined net income of the activities. Taxable organizations which meet the required tests of ownership may also file consolidated tax returns. While this difference in the law has probably not been a major factor in causing exempt organizations to transfer their taxable activities to taxable subsidiaries, they generally do take advantage of the more favorable rules afforded such organizations. To apply the UBIT rules to such subsidiaries is arbitrary and discriminatory, since it would impose higher taxes on subsidiaries of exempt organizations than are imposed on their commercial competitors. To the extent any exempt organizations may be assigning unprofitable exempt activities to taxable subsidiaries in order to absorb income from profitable commercial activities, the IRS currently has sufficient power under Section 482 of the Code to make the adjustments necessary to correct this abuse.

G. Aggregation of Activities of Controlled Subsidiaries. Of the options proposed, the possibility that a rule will be enacted under which taxable subsidiaries will, in all cases, be aggregated with their parent in determining whether the primary purpose of their parent organization is charitable, presents the greatest threat to exemption of organizations such as Butterworth. While such a rule sounds reasonable at first, it is objectionable on both policy and practical grounds. Some of the problems associated with this sort of rule include the following:

1. Anticompetitive Effects. One of the consequences of aggregating exempt and non-exempt corporations would be to impose a substantive limit on the size of taxable subsidiaries. In the case of an industry such as health care in which legitimate medical services are provided by both taxable and exempt organizations, this limits the ability of exempt organizations to compete in those segments of the market which are taxable due to their traditional domination by for-profit providers. Such a limitation would apply notwithstanding the fact that the subsidiary enjoyed no tax advantage over its commercial counterparts. While proprietary competitors might benefit from such a rule, sound public policy does not support its imposition.

2. Taxable Subsidiaries which Further Exempt Purposes. In many cases exempt organizations have taxable subsidiaries for reasons which go beyond the desire to receive the revenue generated by commercial activities. Section 4944(c) of the Code expressly recognizes that private foundations may at times make program related investments, such as loans for low income housing, which further the charitable purposes of the organization. Public charities frequently have

similar programs. For example, an organization may have a taxable subsidiary which is clearly engaged in commercial activities but which promotes minority employment. The Butterworth group provides an example of a comparable situation. Virtually all of the activities of both the exempt and taxable entities in the group involve the provision of health care services. One of the taxable subsidiaries of Butterworth Ventures, Butterworth Med + Centers, provides ambulatory medical care. Employers and payors for health services such as HMOs and preferred provider organizations are increasingly interested in contracting with providers which are able to provide a full range of health care services. Therefore, by enabling the Butterworth group to furnish more complete services, Butterworth Med + Centers expands the number of patients served by Butterworth Hospital. Any rule aggregating exempt and non-exempt subsidiaries must give fair consideration to the contributions made by taxable organizations to the exempt functions of related organizations. In the case of health care organizations, this could be achieved by providing that revenues generated by medical care which is deductible under Section 213 would not result in the loss of exemption.

3. Technical Issues. In addition to the consideration of policy described above, an aggregation rule presents practical and technical problems. Because exemption is so vital for many exempt organizations, they require clear guidance on what activities are permitted and what are not. Therefore, general language on aggregation of activities would create uncertainty not unlike the uncertainty caused by the rule which provides that "no substantial part" of the activities of an exempt organization can consist of lobbying. A more precise definition is likely to give rise to complex technical issues. In measuring the "principal purpose" of an exempt organization under current law, many tax advisors look at the composition of the revenues of the organization. In doing so, some view investment income as "charitable" and some do not. There are also questions as to whether "passive" taxable income, such as unrelated debt financed income taxable under Section 514 and interest from taxable subsidiaries which is taxed under Section 512(b)(13), affects the charitable character of the organization. As mentioned above, there are also issues as to how income from taxable organizations which contribute to the achievement of exempt functions should be counted. In addition, there are even more exotic technical issues. For example, consolidating the financial statements of related organizations results in the elimination of transfers between organizations. In the case of the Butterworth group, some of the income of the group consists of payments for HMO contracts which are subsequently transferred to the Hospital to provide inpatient services for HMO subscribers. A detailed rule for the aggregation of the activities of the group would have to provide guidance as to whether such income was to be characterized as revenues of the Section 501(c)(3) Hospital or of the Section 501(c)(4) HMO, and, if the latter, what effect, if any such income would have on the tax status of Butterworth.

H. Allocation Rules. Current law provides that when an exempt organization uses facilities for both exempt and non-exempt purposes, costs such as depreciation and general overhead are allocated between exempt and taxable activities and those allocated to the taxable activities become deductible. It is proposed that only the direct costs be deductible and that no deduction be allowed for general overhead and depreciation. The justification for the change is apparently that the IRS has had difficulty in making the allocations. Commercial competitors of exempt organizations enjoy the benefits of comparable deductions, so this is another example of a change which would put exempt organizations in a less favorable tax situation than their competition. In the case of health care organizations, such a rule would be particularly inappropriate. Under current law, hospitals still receive cost based reimbursement from Medicare for capital costs incurred in the acquisition of their facilities. When a hospital uses a portion of its facilities for purposes unrelated to patient care, Medicare has, since the inception of the program in 1966, allocated the depreciation and overhead costs associated with the space used by the unrelated activity to a "nonreimburseable cost center," thereby denying reimbursement for that portion of the cost. To deny tax deductions for the allocated costs would put the federal government in the position of claiming that it knows how to do cost allocations when it is in its interest but does not know how to do what may be an identical calculation when it benefits the taxpayer.

Butterworth has appreciated the opportunity to provide these comments and would be pleased to provide additional information on request.

California Academy of Sciences

Natural History Museum & Aquarium

April 14, 1988

Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Re: Discussion Options Relating to the Unrelated Business Income Tax

Dear Representative Pickle:

I am replying to your request for public comment on behalf of The California Academy of Sciences -- a 135-year-old institution comprised of the Steinhart Aquarium, Morrison Planetarium, Natural History Museum, science exhibits, and vast scientific collections. Each year, 220,000 school children visit the museum for science education, and 1.5 million visitors tour our public exhibits and participate in our public programs. Our collections are used by the FDA, Customs, the Department of Agriculture, NOAA, and other federal and state bureaus for the identification of plants, pests, and dangerous organisms.

These scientific and educational activities would be severely damaged by certain options in the Bill.

The California Academy of Science derives income from a cafeteria for its visitors, the Academy Store, and a travel program on which its scientists teach. This income is critical to our survival in an environment of reduced tax incentives for charitable donations, reduced federal funding to cities -- indirectly resulting in a drop in city support from 38 to 14 percent of our operating costs -- and increased competition for private donor funds. More than ever before, we and other museums depend on the small revenue we derive these activities to balance our budget.

Our principal objections to the proposed Unrelated Business Income Tax are as follows:

1. The arbitrary taxation of educational materials under the substantially related" test is inappropriate for museum stores. Visitors to natural history exhibits are stimulated to purchase books, anthropological artifiacts.microscopes,telescopes and field glasses, magnifiers, posters of wildlife, or other natural history objects. Whether they represent our specific exhibits, those in another museum, or an endangered rain forest found in no museum, these purchases help in remembrance of some natural history object, fact or principle, and stimulate further learning. Many of the purchases, though not directly related to the science education mission, play an important and reinforcing role in the educational experience.

2. The UBIT should not apply to mail order from museum stores when they are part of the general educational mission of the institution. Our scientists are actively involved in setting museum sales policy. They take considerable care in making sure that sales items have not endangered fossil beds or living Pacific shellfish populations, for instance, and that the science message or written material is accurate. Science education is the thrust of their efforts, and in contrast to many for-profit, mail-order companies selling science-related material, museum sales profits go directly to this end.

3. The option to apply UBIT to travel and tour services is unreasonable. On all Academy run travel, domestic and overseas, Academy scientists with the highest qualifications and experience lecture on geology, zoology, botany, oceanography, etc. These trips are richer learning experiences than traditional natural science courses of lectures with slides. The travel program fulfills the educational mission of the Academy of Sciences in the very places where the natural history happens. The meager funds realized from such programs again return directly to scientific research and education.

4. The "control" percentage should not be reduced to 50 percent. To protect its charitable 501-C-3 status, the institution may segregate the IRS-defined UBIT activities in a taxable subsidiary. The institution still needs to maintain real control of this subsidiary to assure furtherance of the parent's goals.

5. Allocation rules are not in compliance with generally accepted accounting principles relating to matching of revenues and expenses. General overhead and depreciation are very much a part of operating expenses necessary for revenue generation. To exclude them by law is to unfairly maximize the taxable income base, to the detriment to any business concern which strives to be economically viable.

Museums serve important cultural needs. They also provide important educational curriculum support to teachers frequently faced with limited public school resources. Yet many of our nation's great science museums are struggling against increasing odds to provide quality science education. Their costs of operations continue to increase while support from governmental institutions decreases. The changes your committee proposes would likely be fatal to many museums and debilitating to all. We urge your support for the present system.

Very truly yours,

Frank Talbot (sd)

Frank Talbot
Executive Director

Golden Gate Park San Francisco, California 94118 (415) 221-5100

CC
PH

California Committee for the Promotion of History
California History Center
21250 Stevens Creek Boulevard, Cupertino, California 95014 • (408) 996-4712

April 15, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

As a museum director, a board member of numerous Kern County nonprofits, and Vice Chairman of the California Committee for the Promotion of History, I want you to know that some of the discussion options being considered by the House Ways and Means Oversight Subcommittee to tax nonprofits will have a very serious negative impact on museums and other nonprofits. While I am fully aware of the need for the federal government to raise additional revenues to offset our national debt, this is not the way to raise it. Such taxation is a slap in the face of the majority of citizens in California and across the nation who volunteer their time or make a point to patronize or purchase from nonprofit organizations. I find it ironic that 230 members of the U. S. House of Representatives have joined as co-sponsors of HR 911, the Volunteer Protection Act, yet the House Ways and Means Oversight Subcommittee is considering taxing their work in inappropriate ways. The Reagan Administration and others before it have made much of our unique national treasure, which is volunteerism. I would urge you to examine very carefully the various options proposed to tax their efforts, lest serious harm be done to the heritage and future of volunteerism in this country.

The California Committee for the Promotion of History has over 200 members who hold administrative and professional positions in a variety of organizations in communities throughout California. They are actively involved in education, museums, historic preservation organizations, and a wide variety of other nonprofits. It appears that some of the taxation options being considered would strike at the essence of the educational purpose of these organizations, curtail their revenue producing ability severely, and affect their ability to build and maintain a membership base. The proposed changes in the substantially related test for gift shops, taxation of "off premises" sales and tour and travel services are of the utmost concern to all of us. In addition, the repercussions down through all levels of government that rely increasingly on volunteers and nonprofits to provide services will be greatly and negatively impacted by changes in our tax structure as suggested.

Taxation of the work of volunteers is a very serious threat to our social and cultural fiber in this nation. We should be encouraging such activities in difficult economic times, not sabotaging them. There has got to be a better way to regulate the unrelated business income of nonprofits than the sweeping tax changes proposed.

Sincerely,

Carola G Rupert

CGR:wjw

Carola G. Rupert
Vice Chairman

CALIFORNIA
VETERINARY
MEDICAL
ASSOCIATION

RICHARD SCHUMACHER, DVM
President

April 12, 1988

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Pickle:

The California Veterinary Medical Association is pleased to have an opportunity to address you and the Subcommittee members on an issue of great concern to our profession in California and nationwide---the abuse of tax exempt status by non-profit organizations.

The California Veterinary Medical Association (CVMA) is a professional association with over 3,500 members, representing all segments of the veterinary profession, including private practitioners, educators, public health personnel, and veterinarians involved in industry and research. Our association has taken the position that non-profit organizations, including associations such as our own, should not be permitted by federal tax laws to compete unfairly with private businesses.

We wish to commend you, Representative Schulze and the entire subcommittee for developing an excellent series of options to deal with this highly controversial area. Your discussion options treat the concerns of both the non-profit community and the business community with sensitivity and fairness, and we believe that many of these recommendations should be included in the Subcommittee's final report.

With regard to the specific options that are presented, we support the concepts embodied in Recommendation I.F., pertaining to the application of UBIT to certain veterinary services.

However, we would recommend the amendment of this item, because there are many elective veterinary procedures that do not involve surgery. In addition, the current language would allow a veterinarian employed by a non-profit organization to perform a wide range of services by "recommending" them for the health of the aninal. We believe that this allows too much latitude, and would not resolve the problems that exist in this area.

We believe that more appropriate language would be,

> "... certain veterinary services such as grooming, boarding, and elective veterinary medical procedures (with exceptions for measures mandated by state or federal law or regulations to protect the public health).

However, the expansion into elective veterinary services, and even into the boarding of animals for profit, exceeds the charitable purposes of non-profits and should not be subsidized by the public through tax exemption.

We recognize that there are many non-profit facilities currently in existence that provide services ranging from spaying and neutering of animals to full service veterinary (even specialty) care. While we recognize the good intentions of these facilities in attempting to provide care for animals, they are duplicating services that are already available from private practitioners. The veterinary profession has demonstrated its willingness on many occasions to cooperate in partnership arrangements that would facilitate the delivery of needed care to animals owned by economically underprivileged people. We believe that any organization providing veterinary services other than measures that are mandated to protect the health of the public should be required to compete fairly through equitable application of federal and state taxes.

The veterinary profession's concern with the issue of unfair competition by non-profit organizations is widespread throughout California. In a 1986 survey conducted by our association, we contacted each of our 27 local (county) chapters regarding this problem. Of the 26 responses, 17 chapters reported the existence of competition from non-profits, with some chapters reporting multiple non-profit facilities offering services in their counties. Five counties reported that additional non-profit veterinary hospitals were planned in the near future.

We would also like to comment on another option presented for discussion.

With regard to option I.A., we do not believe that a blanket requirement for application of UBIT to all off-premise (phone or mail order) sales of books and educational materials is appropriate. Many non-profit organizations distribute educational materials directly related to their charitable or educational purpose to their members and the public by mail. This is necessary because of the geographic diversity of the membership and the public they serve. Many association members are unable to attend educational meetings due to professional, economic or other reasons, but they can receive much of the information through purchase of printed proceedings or tapes of these meetings. The provision of this information by mail is an integral part of our educational purpose, and would be inappropriate to tax. We recommend that these "off premise sales" should be subject to the "substantially related" test.

Thank you for the opportunity to comment on this important issue.

Sincerely,

Richard Schumacher, DVM
President

cc: California Congressional Delegation
CVMA Board of Governors
Constituent Association Presidents/Secretaries
AVMA Washington Office
California Business Coalition

CALVERT MARINE MUSEUM
P.O. Box 97 Solomons, Maryland 20688
(301) 326-2042

April 12, 1988

Robert J. Leonard, Chief Council
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

I am very concerned about possible options the Subcommittee on Oversight is considering on the issue of taxation of non-profits' revenue-producing activities. I've been connected with the museum non-profit world since 1964 and a museum director since 1974. In my own experience I can tell you my institution will be severely impacted if these options are adopted. Specifically, our museum store strives to make all our merchandise appropriate and educational to the themes of our institution. In fact, we consider our store an educational arm of the museum first, a revenue generator second. We therefore do not sell souvenirs which under these options would not be taxed; but instead we sell books, model kits, and educational toys that visitors can take home and learn more about our themes. Ironically, these very items would be taxed. This doesn't make sense. In effect, this portion of the subcommittee's report will encourage our museum shop to become nothing more than a souvenir stand -- this is shameful. Some museum stores may abuse the present tax laws, but why punish everyone for what the wrong doers have done? Why not encourage museum stores to sell merchandise that actually enhances and informs the visitors?

My institution presently does little or no "off-premise" sales, travel and tour services, or receives royalties, but my same argument above applies. If the activity is truly an educational arm of the institution, why penalize it? If a museum has a book printed by a publishing company, why impose a tax on any royalties it might receive? Aren't we actually doing a service to the public to get educational information in their hands? Even children's coloring books can be very effective in teaching concepts and ideas about nature, culture, and science. In our case, all profits from such sales go back into our publication fund. Why penalize us?

I object strongly to the options outlined above as they hinder instead of enhance the very purpose of what museums are all about. I urge your support in defeating the subcommittees recommendations. Please feel free to contact me if you wish to discuss this further.

Sincerely,

Ralph E. Eshelman
Director

REE/jp

cc: Congressman Roy Dyson

THE CANTON ART INSTITUTE

Subcommittee on Oversights,
House Committee on Ways and Means
Longworth House Office Building
Room 1105
Washington, D. C. 20515-6350

April 13, 1988

Re: Taxation of Non-profit Organizations

To whom it may concern:

In response to the House Ways and Means Oversight Subcommittee's call for public comment on the issue of taxation of the revenue-producing activities of non-profit organizations, the five members of the Administrative Staff of the Canton Art Institute would like to make the following observations about the potential harm of such a law. Unlike the situation which exists in many foreign countries where considerable support funds are provided by the government (with the attendant consequence of government supervision, influence, and control), museums in the United States derive only a small portion of their annual budget from Government sources. American museums thrive on their independent status, requiring the energetic participation of the communities they serve to assure their future success.

As you are aware, our nation's non-profit organizations provide countless public services for a minimum well considered expenditure. And it has been the policy of many American museums to offer their services on a free admission basis. In instances where an admission fee is charged, the annual revenues realized from such a fee comes to only a small percentage of the total annual operational budget.

Everyone seems to recognize the important role of American museums of all types--art, historical, science--in educating Americans, and in improving their quality of life. The broad-based long-term result of this dedicated effort has been to make the United States a better place in which to live, to reinforce its image as an nation with a rich cultural heritage, and to demonstrate a sincere conviction in preserving our American patrimony and making the evidences of our culture available to all. But this enormous responsibility cannot be fulfilled with continuous and incessant encroachments on our diminishing base of financial support.

1001 MARKET AVENUE, NORTH • CANTON, OHIO 44702 • (216) 453-7666
IN THE CULTURAL CENTER FOR THE ARTS

Much of our funding is accomplished through various activities such as membership dues and occasional fund-raising activities--and through other revenue-producing activities such as a museum shop, and travel and tour services. In many museums, these very activities have meant the difference between keeping the doors open to the public, cutting their hours, or closing entirely. The adoption of such a law would constitute a very damaging act against American museums and other agencies extremely dependent on such revenue-producing activities, with devestating repercussions throughout the museum field far exceeding the monetary benefits generated for the Federal Government.

We fervently hope that our government representatives who have a sincere interest and a profound concern in the continued cultural enrichment of our nation will make a concerted effort on our behalf to defeat this unfortunate proposal.

Sincerely,

Joseph R. Hertzi,
Director

M. J. Albacete,
Associate Director

Fran Lehnert

Betty Jo Adams,
Business Manager

Frances Lenhert,
Curator of Education

Sharon D'Atri,
Development Coordinator

cc: Samuel Krugliak,
President of the Board of Trustees,
The Canton Art Institute

Congressman Ralph Regula

Geoffrey Platt Jr.,
American Association of Museums

CANYON HEARING AID CENTER
2809 CALDWELL BOULEVARD
NAMPA, IDAHO 83651

FRANK McCUSKEY, B.S. C.H.A.A.
DAN F. McCUSKEY, B.A. C.H.A.A.

PHONE [illegible]

BY APPOINTMENT ONLY

April 12, 1988

To: Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

The nonprofit hospitals and organizations selling hearing aids for profit are a blight to the capitalistic system that makes this country great. In no way is it fair for a small business to pay taxes on their efforts and at the same time allow a large nonprofit hospital to pay no business taxes.

I feel the Unrelated Business Income Tax (UBIT) should apply to all commercial hearing aid sales by nonprofit organizations. Also, the existing convenience exemption for patients is absurd.

The Elks Rehabilitation Hospital in my area sells hearing aids. The staff in that hospital has torn the labels off hearing aid batteries and told their customers that their hospital is the only place they can buy them. Many of their customers live a great distance from the hospital and it would be much more convenient for them to buy batteries at a local drug store or hearing aid office. Also, hearing aids require service such as cleaning and new earmold tubes. This is many times conveniently done closer to home at the local hearing aid office.

Please apply the UBIT to hearing aid sales income of nonprofits and repeal the convenience exemption.

Sincerely,

Dan F McCuskey

Dan McCuskey
Board Certified, CHAA

DMC:pbe

Carey's Hearing Aid Service
210 East First St.
Moscow, ID 83843
Tel: (208) 882-2325

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC. 20515

RE: Unrelated Business Income Tax

The Honorable Robert J. Leonard:

I strongly urge you to support reform measures currently proposed regarding the Unrelated Business Income Tax system, particulary in the area of commercial hearing aid sales by non-profit organizations.

The engagement of non-profit entities in numerous commercial activities undermines the competitive economic structure that has helped to produce the great world stature that the United States enjoys today. The original premise of non-profits enjoying tax advantages because they serve "charitable" functions is simply no longer valid in a vast number of situations as many of these organizations shift from charitable to commercial activities. If these organizations want to be part of the free enterprise commercial system, they should be treated as any other commercial entity, thus removing the terrific competitive edge that their non-profit status provides.

There are fifty-one hospitals in the state of Idaho. Forty-nine of these hospitals have non-profit status. It came to light during the past state legislative session that the expansion of hearing aid dispensing in the non-profit hospital setting is adamantly supported by hospital management around the state. The hospital in Moscow is not currently dispensing hearing aids, but it has recently attracted two otolaryngologists who will arrive this spring and summer. Hearing aid dispensing follows as a natural progression.

The greatest non-profit competition currently in my area is Washington State University. Their speech and hearing clinic provides hearing aid services to the public and has actively pursued new clients by direct mail. I have no way of enumerating the potential business lost to them because of the price differential their non-profit status allows.

I urge you to support not only the proposed UBIT, but any and all legislation that prevents non-profit encroachment into the commercial market.

Cordially,

Bob Shepard

cc. Larry Craig, Idaho State Representative

THE CARROLL CENTER FOR THE BLIND
(Formerly The Catholic Guild for All the Blind)*
770 Centre Street, Newton, MA 02158-2597
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Mass. Toll-free Number: 1 (800) 852-3131

April 12, 1988

Robert J. Leonard, Esq., Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to express my concern about the Subcommittee on Oversight, Committee on Ways and Means' preliminary options regarding the UNRELATED BUSINESS INCOME TAX (UBIT). As I have read the options, and upon advice, it appears that by repealing the "regularly carried on" test, the Committee would open the door for taxation of once-a-year fundraising events such as our annual Ball. This event is partly based on donations from the public (such as donations of printing, donations of flowers, donations of gifts), as well as partially based on payment to the hotel for the actual cost of the dinner for the guests.

As I understand it, any "profit" that we realize would be taxable.

If my interpretation is correct, this would revise the 200-year history of support for educational, social, health and cultural causes.

On the one hand, government wants to get out of the business of "being all things to all men" and providing for every social need -- "Let the private sector do it..."; on the other hand, this kind of taxation destroys our ability to raise the money to do just that.

Perhaps I have been misinformed. Could you please clarify if that would be the outcome.

Sincerely,

Rachel Ethier Rosenbaum
Rachel Ethier Rosenbaum
Executive Director

RER/lvd

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*Renamed in honor of the late Rev. Thomas J. Carroll, Executive Director for 25 years and founder of its internationally known services for the blind.

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INTRODUCTION

The Catholic Health Association of the United States (CHA) has a nationwide membership that includes over 900 acute and long-term care health facilities sponsored by Catholic religious congregations and dioceses. On June 26, 1987, Sister Bernice Coreil, the Provincial Administrator of the West Central Province of the Daughters of Charity of St. Vincent de Paul, testified at the Oversight Subcommittee's hearing on the unrelated business income tax (UBIT) on behalf of the CHA.

CHA's testimony stressed three facts that it continues to believe the Subcommittee should consider in evaluating any change in the UBIT.

1. Private, not-for-profit health care institutions are the mainstay of our nation's health care system, providing about three-quarters of all community hospital beds, three-quarters of all uncompensated hospital care, and similarly large amounts of all medical education and research. Any change in the tax law that affects their ability to deliver health care services will affect the health care system as a whole.

2. The mission and the exempt purpose of Catholic health care institutions is the promotion of health, broadly understood; it is not limited to providing acute, inpatient hospital care. Catholic health care institutions have a centuries-old tradition of providing a wide range of health care services according to community needs, the medical state-of-the-art, and the overall health care environment. Catholic health care began in the home, then was provided at a variety of community institutions, moved to the hospital relatively recently, and now is increasingly being provided in the home and other community institutions again. Catholic heath care is holistic and deals with not only the physical but also the emotional and spiritual needs of the patient while providing a continuum of care from the hospital to the home. Thus, the provision of outpatient care has always been and will continue to be an important part of Catholic health care.

3. The essential difference between not-for-profit and for-profit health care providers is their essential purpose, aptly described by their respective names. The purpose of Catholic health care providers is comprehensive healing, community service, and medical education and research. Operating surpluses, where they exist, are used to expand services, meet future capital needs, and cover future deficits, not to provide a return to shareholders. It is important to our health care system that the not-for-profit sector not be discouraged from providing health care services.

Unfortunately, the "discussion options" do not reflect an understanding or appreciation of these facts. By seeking to treat as unrelated most outpatient (as well as many inpatient) services, the scope of the proposal would be wide ranging. In addition, the impact of treating these health care services as "unrelated" would result not only in Federal income tax liability, but also would result in the imposition of state and local income, sales, and property taxes and would prohibit the financing of facilities for such activities with tax-exempt bonds.

For these reasons, most of the discussion options involving health care would significantly discourage the provision of many health care services by not-for-profit institutions and thereby discourage the total amount of such services provided, even though there is wide agreement that these services should be increased. The services that Catholic health care institutions are providing will continue to be needed by communities, regardless of changes in the UBIT law. In most cases, the need will continue to be ignored by commercial interests because they are not "profitable." So the impact of these proposals would be to eliminate needed health services.

COMMENTS ON DISCUSSION OPTIONS

I. Substantially Related Test

Our understanding of the UBIT law as applied to health care institutions and our review of the hearing record on this issue does not suggest a fundamental failure of the policy of the UBIT or the present "substantially related" test. We agree with the Treasury that this test seems to be working well and should not be changed. The substantial adverse effects on the health care system that would be caused by the discussion options that would change the test demonstrate the wisdom of retaining the current test.

Directly Related Test

The proposal to replace the "substantially related" test with a "directly related" test is obviously intended to reduce the range of activities that would be considered exempt purposes. Because the new test is undefined and no examples of its scope are given, however, we do not know what activities would be excluded or on what basis. It is therefore difficult to comment with precision on the impact of the proposal on the health care system.

It is clear, however, that some if not all of the rulings made under the present test would have to be reevaluated under the new test. This would create great uncertainty and deter the creation of new health care services such as satellite clinics in poor inner city and rural areas, facilities for AIDS patients, alcohol and drug abusers, and the developmentally disabled, and other health care services that we are now trying to move out of the hospital and into other settings which are more cost-effective and which improve access for underserved patients.

Analysis of Individual Income-Producing Activities

This is another proposal that is undefined and unexplained and therefore difficult to comment on with precision. It would abandon totally the concept of relatedness and replace it with an activity-by-activity analysis of exempt purpose.

If the proposal is intended to examine the exempt purposes of parking lots, cafeterias, and gift shops without consideration of their connection to the hospital, we assume that these parts of the hospital would not be deemed to have a charitable purpose, would be unrelated, and therefore would be subject to the UBIT (and to state and local income, sales, and property taxes and that those parts of the hospital would not be eligible for tax-exempt financing). If the proposal would extend to laundries or utility plants, it would be necessary to allocate part of the daily charge for the patient to these activities, and then probably subject this income to the UBIT. But all these activities contribute importantly to the provision of health care services and they must be considered in context.

If our outpatient activities, such as homemaker services and meals-on-wheels programs provided as part of home health programs and patient transportation to the hospital (both on the ground and by helicopter), are examined out of context, these activities also could be considered unrelated because they may not be deemed to have a charitable purpose. But these activities also contribute importantly to our health care mission and we have found that these services generally are not provided at all unless provided by a not-for-profit institution.

Inherently Commercial Exception

The proposal to create an "inherently commercial" exception to the "substantially related" rule also is not defined. Although the examples suggest the thrust of the proposal, there are no criteria, other than apparently a requirement that a commercial interest desires to eliminate some competition in a specific activity.

If the test is whether for-profit entities operate businesses that provide the same service, then even acute care inpatient services would be considered "inherently commercial" under the proposal. If the test is basically "inpatient vs. outpatient", it would have far reaching effects on Catholic health care institutions. As we discussed in our testimony in June, because of cost reduction efforts by the Federal government and other health care payors and the latest medical state-of-the-art, we are attempting to provide traditional inpatient services on an outpatient basis, both within and outside the hospital facility. This proposal would directly countervail these efforts and the health care policies that encourage the use of lower-cost health care delivery services.

Even if the present application of this test were defined, its impact could apparently change over time as the involvement of commercial interests in health care activities changes. For example, new medical technology is virtually always introduced in not-for-profit health care institutions because it is not "profitable" in the for-profit setting. However, after time, as the cost of the new technology is reduced and patient demand increases based on the experience in the not-for-profit hospitals, for-profit organizations often adopt the technology. This could lead to the situation where new technologies are exempt purposes when they lose money but become taxable when they earn a surplus.

Commercial interests have a history of moving in and out of health care services depending on whether they can earn a profit. Not-for-profit hospitals do not provide health care for the purpose of earning a profit, but rather as a service to their communities. It would therefore be counterproductive to our nation's health care delivery system to define health care services as charitable or not according to whether or not the for-profit sector believes it can earn a profit on them at any particular point in time.

A. Gift Shop Income

Hospital gift shops provide sundry items for patients, both inpatients and outpatients, and for hosptial employees and staff. Hospital outpatients may be in the hospital all day, as are its employees and staff. This has always justified an exception from UBIT for such sales.

The proposal would exempt from UBIT only income from sales to inpatients. We are unaware of any reason to so limit the exception.

B. Outpatient Income

This part of the proposal also is somewhat unclear, but provides that income from sales, rentals and fees for medical equipment and laboratory testing are UBI except for "inpatients, continuous-care outpatients, or emergency treatment outpatients" or for "items not available in immediate geographic area."

Catholic health care institutions are attempting to provide access to adequate health care in the most cost-effective manner. In many cases, this means bringing the service to the patient, out of the hospital. This proposal appears to subject to the UBIT (and result in all of the other disadvantages applicable to unrelated activities) several services we now perform, and want to increase our performance of, such as:

- portable x-ray, mammography, and ultrasound units that are brought to areas where underserved, usually indigent, patients live;

- portable CAT scanners and MRI machines that are shared among hospitals to reduce hospital capital costs;

- mobile clinics and satellite clinics for poor inner city areas and rural areas; and

- home health care services, including home care for AIDS patients.

These are precisely the types of innovative, lower-cost services that the Federal Government should, and usually does, encourage.

In addition, we do not understand how the "immediate geographic area" of persons who are in effect confined to their home because of age or other infirmity would be determined for the purpose of this rule?

E. Adjunct Food Sales

On-premises food sales should also include sales to a hospital's patients and staff. Why should a meals on wheels program, that is part of some of our home health care programs, that provides nutritionally balanced meals to the elderly and bed-ridden be discouraged by the application of the UBIT? We are unaware of any significant commercial interest in providing this service at a reasonable cost.

H. Routine Testing

The proposal would limit the exception from UBIT for medical testing to "pre-surgical" testing. We do not understand the tax policy imperative that would override the health policy concerns regarding AIDS testing and drug testing for non-patients. We do not understand why post-surgical testing of inpatients and outpatients, including pathology tests that are not for educational purposes, should be discouraged. We do not understand why testing for the many non-surgical procedures performed in hospitals on an outpatient or inpatient basis should be discouraged. These services include insulin regulation for diabetes patients, blood testing for dialysis patients, blood testing for patients with various infectious diseases such as rocky mountain spotted fever or herpes, and various pre-delivery obstetrical tests. What makes these less charitable than tests performed prior to surgery?

L. Additional Specified Activities Determined To be Inherently Commercial

Since the proposal does not state any principle on which to determine what activities are "inherently commercial" it is again difficult to comment with precision. However, given the specific examples discussed above, it appears to us that the standard used to produce the "discussion options" is heavily weighted toward the commercial interests. We do not think this is in the best interest of the health care system to determine what activities are exempt based upon the desires of commercial interests to eliminate competition at any point in time.

II. Convenience Exception

There is presently a significant overlap of the coverage of the "substantially related" test and the "convenience" exception, and rulings have been granted for health care facilities on either or both grounds. The convenience exception has simplified determinations under the UBIT rules by not requiring an application of the subjective substantially related test in all cases.

In the absense of any changes in the substantially related test, the major impact of repealing the convenience exception will be to transfer badly needed hospital funds from medical services to legal services to ensure that presently exempt activities continue to be exempt. However, if the substantially related test is changed, then the repeal of the convenience exception would force a reexamination of a large number of activities and could result in significant disputes with the IRS over the interpretation of the new rules and would not result in any significant increase in Federal tax revenues.

III. Repeal the Regularly Carried On Test

The proposal does not define what would be considered a trade or business for the purpose of the rule. The distinction between the circus (deemed UBIT) and the gala event (not deemed UBIT) is not clear to us. What is clear is that the proper treatment of many fundraising events would be uncertain and some would fail the test. We do not understand what is to be gained through this change.

VII. Aggregate Income and Activities of Controlled Subsidiaries

This proposal, especially combined with other propsals to define most outpatient services as unrelated, could call into question the tax exemptions of some Catholic health care facilities. It could exclude not-for-profit health care institutions from providing medical services in one of the areas or greatest importance to the future of health care in our country -- alternatives to inpatient care.

The proposal would disregard separate legal entities that are separately managed for tax purposes, which is not done elsewhere in the tax code. Health care institutions have set up separate corporations for activities that might be considered unrelated and which, if carried on in the not-for-profit entity, might endanger the exempt status of the institution. This structure is used because the standard used by the IRS for determining if the "primary purpose" of the organization is exempt is undefined (and has been applied in some cases to permit only a very small percentage of income from nonexempt activities). This proposal would eliminate this safety valve that has been used to meet the broad health care missions of not-for-profit institutions within the uncertainties of the tax law.

VIII. Allocation Rules

The proposal would not permit an allocation of overhead or depreciation for deduction against UBI. This would violate generally accepted accounting procedures, under which all costs of business, including indirect costs, are allocated between exempt and nonexempt purposes. It would result in taxing an unrelated business activity of an exempt organization at a higher effective rate than a fully commercial activity.

IX. Consolidated Returns of Affiliated Groups

Many Catholic religious congregations sponsor numerous health care facilities around the country. Despite their religious sponsorship, these are not financially integrated operations. Under the affiliation rules however, which were not drafted with not-for-profit religious institutions in mind, they could be considered affiliated. In most cases, the detailed information needed to prepare a Form 990 is not available on a centralized basis. It would be an economic hardship in such cases to require that this information be centrally collected and a consolidated return prepared.

CONCLUSION

We do not believe that the discussion options, as they would apply to health care, are justified by any claims of unfair competition. Furthermore, several of these proposals would significantly impede the ability of not-for-profit health care insitutions to provide the medical services that their communities demand and deserve and that in the vast majority of cases are not of interest to the commercial interests because they are not "profitable."

We strongly urge the Subcommittee to examine the impact on the health care system of each proposal advanced and determine who would benefit and who would be harmed by these proposals. We believe that this analsyis should result in rejection of most of the discussion options.

CENTER
FOR
NON-PROFIT
CORPORATIONS

STATEMENT OF
JUDITH TRACHTENBERG, ACTING PRESIDENT
CENTER FOR NON-PROFIT CORPORATIONS
TO THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
APRIL 14, 1988

Re: Discussion Options related to the Unrelated Business Income Tax (Press Release #16)

Dear Congressman Pickle and members of the Subcommittee:

I am writing to you on behalf of the 9,000 charitable, religious and educational non-profit groups in New Jersey, to express our deep concern about the above-referenced options. These proposals contain sweeping changes and, in some cases, vague and undefined language which could have the unintended effect of taxing virtually all income-producing activities of non-profit organizations.

Most of the recommendations appear to address claims of unfair competition voiced by small business representatives at the Subcommittee's series of hearings held last June. These advocates have presented anecdotal evidence, but very little hard data, to support their claims that non-profits compete unfairly against small businesses.

Based on our review of these discussion options, it appears that the Subcommittee is attempting to concentrate on tightening some of the exemptions utilized by the larger non-profits, such as universities, hospitals, and other tax-exempt groups. The proposed revisions, while achieving this objective, would also have devastating consequences on the small, fledgling non-profits, such as arts groups, social service providers and day care centers, which comprise a significant portion of our sector. Ultimately, these groups, and the people they serve, would be most severely harmed by the discussion options.

Our comments on some of the proposed options are set forth below:

Retain "substantially related" test, but impose UBIT on specified activities "whose nature and scope are inherently commercial, rather than charitable."

One of the primary criticisms leveled against non-profits concerns their engagement in "commercial," i.e., fee-for-service, activity. Small business advocates create the impression that such activity is new among non-profits, when in fact, non-profits have traditionally charged fees for services, often on a sliding scale based on ability to pay (IRS data from 1945 substantiate that fees for service comprised a major percentage of nonprofit income over forty years ago). Traditionally, income from fees charged to more advantaged clients is used to subsidize the cost of providing services to those who cannot afford them. To tax activities which have, until now, been recognized as within the legitimate scope of non-profit activity, would reduce the ability of non-profits to serve needy people.

This option also contains many vague terms which could cause confusion on the part of the IRS, which must enforce it, and the non-profits which must comply with it. For example:

- The lack of definition of "inherently commercial" activities could allow for selective interpretation and application against "unpopular" non-profits.

- The proposed tax on gift shop and bookstore sales exempts, but does not define, articles "generally used by or for inpatients (for hospitals);" "items of an educational nature which related to the organization visited (for museums and other groups);" and articles "in furtherance of educational programs (for universities)." No such exemption is discussed for other groups, such as nursing homes, social service providers, community service groups and residential treatment facilities, which also serve employees and clients on-premises.

- "Adjunct" food sales is undefined. It is unclear to what organizations the exemption would apply.

Repeal exemption from UBIT for activities that are not "regularly carried on."

Many non-profits, especially smaller groups, rely on annual fundraising activities, such as charity auctions, dances, festivals, raffles, or offer fundraising "premiums" which are treated as sales, to generate a major portion of their income for the year. Such activities, performed on an infrequent basis, can hardly be viewed as "unfair competition;" to tax this income would cripple the fundraising efforts of thousands of non-profit groups and would be de facto taxation of funds given in the spirit of contribution.

Repeal "convenience exception."

The convenience exception helps many non-profits to attract membership, an activity which is frequently an integral part of an organization's exempt purpose. Many of the principal areas of non-profit activity which would be covered under this option are addressed elsewhere in the Subcommittee's proposal, so this option would only have the additional effect of harming the smaller charitable groups which are more dependent on this source of income for their viability.

We support the Subcommittee's efforts to curb abuses of the law with respect to UBIT. However, we believe that UBIT in its present form with better enforcement of the current "relatedness" standard provides sufficient protection against potential abuse.

We feel that it is critical to gather more hard evidence to justify the sweeping changes that are proposed in these options. We support efforts to improve federal data collection on non-profit activity, including:

- The first page of the Form 990 and Form 990-PF should be computerized to allow for improved data collection regarding the activities of tax-exempt groups; the IRS or Bureau of the Census should be authorized to report this information.

- The Bureau of the Census should be authorized to collect and report information on non-profit employment and volunteer activities in its Census of the United States.

- Every five years, the Bureau of the Census should conduct a complete census of non-profit and for-profit service organizations.

- The Bureau of the Census should annually study county business patterns, separating non-profit and for-profit organizations using FICA and Treasury records.

New Jersey non-profits will lose an estimated $590 million as a result of the Tax Reform Act of 1986. Federal funding for human services in the state has declined by $500 million since 1981. Funds available from private contributions cannot compensate for these losses in support; faced with increasing numbers of requests for donations, funders have urged non-profits to become more self-sufficient. Those non-profits which have been able to offset lost federal dollars have often done so by increasing income from sales and fees; those who have been unable to recoup the lost revenue are faced with the hard alternatives of reducing service or client levels.

Clearly, non-profits have been placed in a no-win situation by the present legislative climate. Advocates of tighter UBIT restrictions generally see contributions as the only "legitimate" source of non-profit income;.yet, incentives to donate such as the charitable deduction for non-itemizers, have been eliminated. At the same time, grantmakers encourage non-profits to explore avenues toward self-sufficiency, including income-generating activities.

There is little dispute among participants in the discussion that competition between small businesses and non-profit groups has been increasing. But is this competition unfair? Statistics have not proven that non-profits enjoy an unfair competitive advantage over small businesses; furthermore, small businesses themselves enjoy a number of tax benefits and preferential treatments. The presence of a non-profit providing goods and services in the same field as small businesses is competition, but does not constitute "unfair" competition. In a society which has traditionally regarded competition as proper and healthy to the economy, measures to diminish competition should not be enacted without strong quantitative justification.

In light of the concerns expressed above, we urge you to consider major revision of these proposals and defer acting until more comprehensive data on non-profit activity and competition are available. Thank you for your attention.

City of Chicago
Eugene Sawyer, Acting Mayor

Department of Human Services
Judith Walker
Commissioner
Kraft Building, 8th Floor
510 North Peshtigo Court
Chicago, Illinois 60611
(312) 744-4045

April 14, 1988

Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Attention: Robert J. Leonard
Chief Counsel

Dear Mr. Chairman:

I am writing in response to your Request for Public Comments on Discussion Options Relating to the Unrelated Business Income Tax, March 31, 1988.

The well-being of private nonprofit social service organizations is a matter of vital concern to my agency, the Department of Human Services of the City of Chicago. Our programs enlist the participation of 215 delegate agencies that use departmental funds to deliver social services. These agencies, along with hundreds of others, also use their own resources to pursue related objectives.

Private nonprofit (501(c)(3)) organizations play an essential part in the functioning of Chicago. I believe Congress acted wisely when it relieved them of the burden of federal taxation. The resulting tax subsidy is an excellent investment that yields public benefits far in excess of its cost. By offering services and/or goods at below-market rates, nonprofit organizations serve a public that is larger, and usually less affluent, than that served by proprietary market-oriented suppliers. Often there is no private market for the socially valuable goods and services supplied by charitable organizations; the cost of supplying them may be greater than any price that can be charged for them. For many of these services, nonprofit organizations were the pioneers: discerning needs, and then conceptualizing, designing, and delivering services long before proprietary businesses were even aware of the markets. Examples that come to mind are day care, nursing homes, home health services, urban health/fitness centers, health maintenance organizations, and even hospitals. These are all important innovations that market oriented proprietary organizations would never have made.

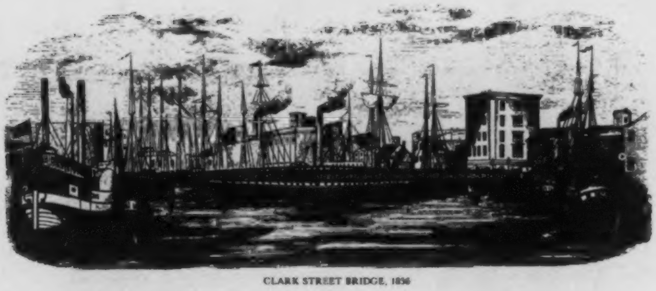
It has been one of the roles of the nonprofits to defray the costs of innovation by drawing on resources from outside these potential markets for services in order to subsidize their creation. Outside resources have come from charitable contributions and fund raising events, tax subsidies, and surpluses from the sale of those among their services and related activities for which a market demand has come into existence. Another role of the nonprofits has been to use these outside resources to subsidize the delivery of established ongoing services at below market rates to persons who could not afford them otherwise. These are the people whom market oriented businesses will not serve. It is especially valuable that nonprofits have the ability to offer the same service to "rich and poor alike," without segregating or otherwise demeaning the less affluent. Thus, I believe that nonprofits have, indeed, vindicated Congress' judgment that they render valuable public service justifying a tax subsidy.

In Chicago nonprofits continue to innovate and to give the private sector a voluntary means of correcting maldistributions of access to the ingredients of a decent life. Innovation is occuring in work with new immigrant communities, with the homeless, and in neighborhood development. Redistribution of resources goes on, as it has, within the whole gamut of private nonprofit social services that are doing work in support of my department's efforts. Even those services that my department purchases from the nonprofits are enhanced by the other work done by those agencies. Any impairment of their ability to advance these recognized public purposes would do us all a great disservice.

Sincerely,

Judith Walker
Commissioner

JW/bje



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April 14, 1988

The Honorable [illegible] J. Pickle, Chairman
Subcommittee on Oversite
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Pickle:

I am expressing my objections to the UBIT discussion options recently advanced by your committee, as well as my dismay at the offensive nature of the options, the apparent absence of understanding about the true nature of museums and current tax law, and the brief time allowed for comment.

Changes in the general environment within which museums must work--recent tax law revisions, the encouragement of greater professionalism and conservation by Federal granting agencies, and the growing and welcome clamor for better public school education, which museums welcome--have caused museums and historical agencies to search for additional means of earned income.

To meet such demands, the Chicago Historical Society recently expanded its museum store and is considering a number of programmatic initiatives that will earn money. These are done as a way of aiding our independence, visitorship, and fiscal well-being.

Against this, your sub-committee's options propose to revise forty years' evolution of public tax policy and significantly increase our burden, particularly by the proposed test to replace "substantially related" with the test "directly related."

The current test is fair and works. The Treasury is not suggesting an alternative. And some discussion options such as the attack on catalog sales are not even part of the question of "substantially related."

Museums represent a public good that this country and its educational systems desperately need. Your sub-committee's attack on them is not only technically and administratively confused, it is bad policy.

The signal that is being sent to Americans and state governments is that museums are not worthy of the support that we now have, although extensive testimony by your sub-committee last year mentions only one item of concern about museums.

I respectfully ask that the "substantially related" standard be maintained or even enforced more vigorously, and that the current law on convenience exceptions and royalty exclusions be retained.

Sincerely,

E H Brown
Ellsworth H. Brown
President and Director

cc: The Honorable Sidney R. Yates
The Honorable Paul Simon
The Honorable Alan Dixon
The Honorable Dan Rostenkowski
American Association of Museums
American Association for State and Local History

The Children's Museum P.O. Box 3000 Indianapolis, Indiana 46206 317 924-5431

Peter V. Sterling, Executive Director

April 11, 1988

The Honorable Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 50515

Dear Mr. Leonard:

I am writing in response to Chairman Pickle's request for public comments regarding the Subcommittee on Oversight's preliminary discussion regarding UBIT.

As the executive director of the largest youth museum in the world (1.6 million visitors last year) I want to express my deep concern that certain new legislation would not only be extremely detrimental to The Children's Museum, but more importantly, to the people it serves. Currently, we are an admission-free museum, located in inner-city Indianapolis, serving young people and their families (as many as 10,000 visitors a day) through enriching educational activities. Since we do not charge admission, we depend on donated income from individuals, corporations and foundations and on earned income to defray the $17,000 a day (over $6 million a year) operating budget.

If our ability to earn income through museum shop sales relating to our educational activities, and/or from food service which we provide to children and their families (the average visitor stays at the museum between 3-4 hours - usually over one meal period) or from museum outreach programs such as the sale of educational materials to teachers, museum members, donors and other museum users through catalog sales, we would have to seek alternative means to make up those income losses.

While there very definitely may be income-producing activities from museums and other nonprofit organizations which are not related to their mission or educational purposes, many of the proposals invade the core of museums' primary mission: to provide educational opportunities to the visiting public at as low a cost as possible. The IRS currently has means to audit the relatedness of an organization's business activities and each organization must live within the guidelines of substantial relatedness.

I am particularly concerned that many inner-city young people who come to the museum literally hundreds of times a year, since it is admission-free and since they find our activities meet their needs, would find the museum less accessible to them if the UBIT proposals become law. It is a case like so many others that are occurring in recent years where the social consequence of legislation, whether it be in regard to adequate housing, drug control, funding for education, ultimately cost the society more than the revenue saved or generated. Each of us must be concerned with finding adequate revenue to support the essential activities of government, but when museums serve hundreds of millions of people in ways that cannot be accomplished by schools or other social agencies, then we need to be extremely careful that we do not jeopardize their ability to serve the people that need their help the most.

I hope, therefore, that in seeking new legislation regarding business practices of nonprofit organizations, that we don't find ourselves in a situation that has serious detrimental social consequences.

Sincerely yours,

Peter V. Sterling

Peter V. Sterling
Executive Director

PVS/mlp

Comments of
Children's Television Workshop, by
David V.B. Britt
President-Chief Operating Officer

The Children's Television Workshop (CTW) appreciates the opportunity to respond to the Subcommittee's request for comments on its "Discussion Options". We ask the Subcommittee to reject the proposal to tax passive royalties based on gross receipts that non-profit organizations receive from licensing trademarks and characters developed as part of their non-profit work.

CTW is an educational corporation chartered by the Board of Regents of the State of New York, and is exempt from taxation under the provisions of 501(c)(3) of the Federal income tax code. CTW is the producer of children's educational television series such as Sesame Street, 3-2-1 Contact, Square One TV, and supporting outreach, research and magazine publishing activities. CTW programs have won Ohio State Awards, Action for Children's Television awards, the Japan Prize, the Prix Jeunesse and nearly fifty EMMYs. In twenty years of broadcast nearly forty million students, have "graduated" from Sesame Street, America's largest school.

The proposal to tax passive royalties based on gross receipts would have a drastic impact on the Children's Television Workshop's major activity, Sesame Street, since CTW relies heavily on passive character royalties to continue production of that series and to develop other educational programming.

Each weekday millions of pre-school children and their parents look to Sesame Street to provide quality education which is available to many in no other way. The series is widely regarded as a shining example of effectiveness in American education.

Sesame Street and CTW's other educational series epitomize the charitable work to which the Congress has long extended the privilege of tax exemption. The quality and scale of CTW's educational programming has not -- and could not -- find a place in commercial broadcasting.

No unfair competition can be charged about Sesame Street product licensing. CTW licensees tell us our royalty rates are higher than other licensors. Our licensees are for-profit businesses which price their products competitively and feel disadvantaged by our advertising restrictions.

To our knowledge, there have been no complaints from businesses or the general public about CTW's licensing activities.

The proposal would undermine continued production of Sesame Street. CTW relies on passive character royalties to finance two-thirds of the cost of the educational series. To our knowledge, no other organization relies so heavily on such royalties to support its non-profit work.

There is no practicable alternative source of funds. Grant funding for Sesame Street from foundations -- which we received in our very early years -- has long since ended.

Direct funding of Sesame Street by the Federal government has also ended. Long before that, the government vigorously encouraged CTW to develop passive licensing and other self-support efforts to replace direct government funding. Now that we have done so, the proposal would punish us for our success.

The privilege of tax-exemption for product license royalties has made it possible for CTW to produce Sesame Street despite these funding cutbacks. By careful character licensing under current law, CTW expects to keep the series fresh and useful for the foreseeable future. Withdrawal or substantial limitation of the exemption would undermine Sesame Street's continued production and availability to children.

Fund-raising from the general public is not a workable alternative. It is very expensive, and even if successful, would likely conflict with fund-raising efforts of public television stations, which are already hard-pressed to pay their current one-third share of Sesame Street costs.

Many Sesame Street licensed products, such as books, records and videos, are themselves directly related to CTW's mission of education and child development. Moreover, Sesame Street product licensing as a whole directly supports our educational mission. Sesame Street must compete with purely entertainment television programming for voluntary viewing. Character licensing helps establish the validity and currency of the Sesame Street television series with its young viewers. The existence of a full product line thus directly promotes viewing and participation in the series.

CTW has a strictly passive role in license income from unrelated products. CTW is not involved in the business aspects of design or sales of such products, such as marketing, pricing, advertising, or production, beyond monitoring compliance with its advertising guidelines. All those business activities are handled by the licensed taxable entities.

Sesame Street licensing operates under strict guidelines which are sharply more restrictive than those for most products for children. CTW is selective about what is licensed. For example, it has turned down licensing proposals for candy, presweetened cereals and war toys. CTW sharply limits advertising of Sesame Street licensed products. For example, advertisements must be clearly directed at parents, not children; Sesame characters must not "pitch" or endorse products in commercials; and television commercials must be concentrated at times when most pre-schoolers are unlikely to be viewing. (A more detailed description of CTW licensing activities is attached).

The proposal would impose a greater tax burden on Sesame Street licensing than is placed on for-profit licensors. For-profit licensors may deduct costs of production, promotion and outreach undertaken to support licensing businesses. CTW could not. Indeed, if CTW had been taxed like a for-profit corporation with similar license income, it would not have generated substantial federal taxes.

The royalty exemption is a revenue-efficient way to encourage the benefits that organizations like CTW provide. Licensed products are purchased with after-tax dollars; the buyer receives no deduction. Licensees pay taxes on profits generated by the use of the licensed names and characters. The only beneficiary of the royalty exemption is the children who watch our programs.

The proposal is a Catch 22 for Sesame Street. It would create powerful incentives for Sesame Street to set aside its current tough licensing standards in an attempt to replace lost revenues. Alternatively, it would push CTW to again seek federal support -- probably unsuccessfully. Or CTW could try to squeeze more money out of public television stations, which are hard-pressed to pay the one-third level of support they now provide.

Most likely the tax would force cut-backs in production, reducing the series' educational effectiveness and audience, leading foreseeably to the end of Sesame Street.

****

Sesame Street is a principal target of this proposal. We believe the facts do not justify its adoption. Please consider the consequences: the proposal would help no one, but would do grave harm to Sesame Street and its audience of millions of children and their parents. We urge the Subcommittee not to adopt it.

ATTACHMENT

CTW PRODUCT LICENSING

1. CTW's product licensing program has three goals:

    -- To raise revenue to support Sesame Street and CTW's other educational activities;

    -- To insure that licensed products, including marketing and advertising, are in keeping with the quality and reputation of CTW's educational programs; and

    -- To help promote and reinforce viewing and participation in our educational programs by establishing a broad base of products which, in many cases, are themselves directly educational.

2. The marketing and advertising of Sesame Street licensed products must adhere to strict guidelines set by CTW. These guidelines are drastically more restrictive than the usual standards for products for children. The guidelines include the following primary points:

    -- All Sesame advertising messages must be clearly directed at adults, not children;

    -- Sesame characters must not be used to "pitch" or endorse products in advertising;

    -- Sesame characters must be depicted "in character", that is, in keeping with their roles in the series;

    -- Television advertising, if any, must be focused in those time periods which foreseeably will have a child audience of less than 10 percent;

    -- Sesame licensed products will not be used in the Sesame Street television series; and

    -- Sesame Street does not endorse non-Sesame products.

    Although many of our licensed products are in categories which traditionally are very heavily advertised on television, such advertising is a very small part of the total marketing efforts of Sesame Street licensees.

3. CTW is selective about products it will license. Over the years the Workshop has been approached by and turned down proposals to license products such as candy, pre-sweetened cereals and war toys. We are particularly receptive to licensing proposals which include low priced products. (Currently suggested retail for approximately 200 products is less than $5).

4. CTW functions as a passive licensor of unrelated products. Licensing activities are conducted by a separate internal department at the highest standards of professionalism. We do not actively engage in product choice, product design, marketing, pricing or any other aspects of the business of the licensee. We do police licensees adherence to advertising guidelines, product quality as proposed, and depiction of Sesame characters.

COMMENTS
OF THE

CHRISTIAN MINISTRIES MANAGEMENT ASSOCIATION

TO THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. HOUSE OF REPRESENTATIVES

CONCERNING
DISCUSSION OPTIONS RELATING TO THE
UNRELATED BUSINESS INCOME TAX

April 15, 1988

The Christian Ministries Management Association (CMMA) is pleased to present its comments on the discussion options relating to the unrelated business income tax, published by the Subcommittee on Oversight on March 31, 1988. CMMA is a national association of over 2500 managers and administrators of churches and other religious ministries, both denominational and independent. In commenting, CMMA wishes to bring to the Subcommittee's attention various consequences of certain options that would particularly affect churches and other religious ministries.

I. Substantially related test.

A. Gift shop/bookstore income.

1. This proposal needs to be carefully and clearly defined. Many religious organizations (other than hospitals and universities) operate "bookstores," services through which members, donors, or the public may purchase religious books and other items. As published, this proposal would appear to tax on-site sales of religious books by a local church, and would also tax mail-order sales of religious books by a denominational publishing house, even if those sales are to churches or individuals that are members of the denomination. These are traditional activities of churches, denominations, and other religious organizations, that have not been the target of complaints about unfair competition, and that should not be subject to tax.

2. "Low-cost" should be objectively defined to avoid litigation, perhaps using the standards of §513(h)(2).

3. The creation of many specific categories of exempt and non-exempt sales increases the administrative complexity required to properly account for and report taxable and non-taxable sales. This is a particular burden on smaller groups that may

have gross unrelated income of more than $1,000, but less than $5,000, for they would be required to file Form 990-T, but, under another discussion option, could not own any tax.

* * * * *

G. Hotels. This option should clearly define a "hotel." Many religious organizations operate summer camps that are rented on weekends during the remainder of the year to other exempt religious, educational, or charitable organizations in an attempt to help these other organizations fulfill their purposes as inexpensively as possible. The rental payment may or may not include payment for meals, services, or camp support staff, or special activities such as the use of horses or boats. These, too, do not compete with taxable entities and should not be subject to tax.

* * * * *

J. Advertising Income and Cost Allocation Rules

* * * * *

2. Advertising Cost Allocation Rules. The proposed rule would place exempt publishers in a worse position than taxable publishers, and because of the rules requiring circulation income to be offset first against readership costs, has no conceptual justification. Any proposal in this area should be aimed at assuring that circulation income is accurately measured and allocated. Otherwise, this proposal appears to be aimed solely at raising taxes.

II. Convenience exception. The repeal of the convenience exception would unnecessarily tax operators of religious camps and retreats who provide a canteen, bookstore, or gift shop for the convenience of those who use their facilities. These sales facilities exist only to serve those taking part in the camp's programs or otherwise using their facilities - which are often located many miles from any commercial facility. They enable campers to make small purchases of necessities, e.g. religious books, toothbrushes, snacks, etc. without requiring them to travel off the premises and thereby miss a portion of the program. For these reasons, such "camp stores" do not compete with commercial stores, and should not be subject to tax.

III. Regularly carried on. The proposed exception for "a once-a-year fund-raising gala event" needs further clarification. A "once-a-year fund-raising gala event" may, for example, take place over a period of a week, or, in the case of a national organization or a university, be held sequentially throughout the year in many different cities. If the Subcommittee proposes to tax these types of events, this should be clarified so that affected organizations may comment on such a proposal.

IV. Royalties. Repeal of the exclusion for gross percentage or flat fee royalties derived from the "goodwill" of an exempt organization has no foundation in concept or application. The IRS has already adopted the position that a payment in exchange for substantial marketing services is not a royalty. Rev. Rul. 81-178, 1981-2 C.B. 135 (Situation 2). Moreover, the licenses generating the royalties nearly always have a taxable business as the "active" party, thus raising its costs relative to other marketers of similar products, increasing competition among taxable businesses, and possibly leading to higher income tax collections from taxable businesses.

* * * * *

VIII. Tax Information/Reporting. If the specific deduction is increased to $5,000, an option not discussed, but which should be adopted, is to increase the gross income threshhold for filing Form 990-T from $1,000 to $5,000.

IX. Miscellaneous Options.

A. Piecemeal Exclusions.

(a) Low-cost articles. Repeal of §513(h) may prove administratively unworkable because, when no payment is required to retain an item already distributed, the income cannot be said to be "from" the distribution of the item. Moreover, many small organizations will find it impossible to trace the connection between the distributed item and the subsequent contribution.

* * * * *

(f) Certain trade shows, etc. This provision would tax the quintessential exempt function of exempt religious and educational membership organizations, as well as many non-membership organizations: meeting together for religious and educational purposes. Here, too, exempt organizations do not compete with taxable businesses, and this provision appears to be designed solely to raise revenue.

Conclusion

The Christian Ministries Management Association believes that many of the discussion options have not been sufficiently distilled to clear principles that will assist both the IRS and exempt organizations in their administrative and reporting responsibilities. Other provisions are theoretically or practically unsound, and may have particularly severe effects on smaller organizations that are unable to afford the complex accounting systems that the new rules would require. Should the Subcommittee or its staff have any questions about CMMA's comments, please do not hesitate to contact our Executive Director, Sylvia Nash, at 1930 South Brea Canyon Road, Suite 170, P. O. Box 4638, Diamond Bar, California 91765, (714) 861-8861.

TO: SUBCOMMITTEE ON OVERSIGHT;
COMMITTEE ON WAYS AND MEANS
US HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG
WASHINGTON, D.C. 20515

STATEMENT OF CIVIL AIR PATROL IN REGARD TO OPTIONS RELATING TO UNRELATED BUSINESS INCOME TAX.

Civil Air Patrol, a federally chartered corporation under 36 USC Sections 201-208 is designated the Auxiliary of the Air Force under 10 USC 9441 under which CAP is also designated an instrumentality of the United States for civil liability purposes in the course of mission performance. CAP has been tax exempt under Section 501(c)(3) since 1947. Under that same statute federal appropriated funds are authorized for CAP equipment and the Air Force is authorized to provide logistic and personnel support. CAP is an all volunteer organization.

The purpose of this statement is to request this Committee to recognize the unique structure and functioning of CAP and to continue the tax exempt status of the organization and its two basic sales supply stores.

CAP has some 73,000 volunteer members nationwide. It is organized into a National Headquarters at Maxwell AFB, Alabama, eight region headquarters, and fifty two wings. There are wings in each state plus Puerto Rico and the District of Columbia. As can be seen from its congressional charter CAP is an aviation related organization with three main programs: (1) emergency services, i.e. search and rescue, disaster relief, etc.; (2) aerospace education and (3) a cadet program.

CAP owns and operates some 540 light aircraft, with acess to some additional 8000 member owned aircraft. CAP owns and operates some 1500 vehicles and 27,000 radio stations. In its most well known role CAP performs through its volunteer force, over 85% of all air search and rescue missions in this country each year saving the Air Force and the country many millions of dollars not to mention hundreds of lives. Since 1985 CAP has been working with US Customs in drug interdiction missions in various parts of the country. CAP also assists various states and local communties in natural disasters.

There are approximately 45,000 senior (adult) members and 28,000 cadets (youth members). The cadets are trained in aviation related matters and oriented toward military or aerospace careers. All of these are volunteers. CAP has only 40 employees and relies on the Air Force for staffing its National

Headquarters at Maxwell AFB Al.

Since its formation CAP has worn a uniform similar to the Air Force. It is the Air Force blue uniform with distinctive insignia and patches. Congress recognized CAP's right to retain those uniforms, insignias and patches by Section 206 of Title 36 USC.

CAP operates a uniform supply store at Maxwell AFB Alabama. That store does mostly a mail order business to CAP members nationwide and provides them with the uniforms, flight suits, insignias, and regulations pertinent to CAP. It is emphasized that these sales are only to CAP members or CAP units. There is a mark-up on those sales which generates about $100,000-$200,000 net each year. Those funds are used in the National operating budget. The National operating budget consists of about $1 million in dues income and whatever the store produces. Out of those funds CAP pays almost $700,000 for insurance and the rest goes to various programs. It is also emphasized that to our knowledge this store does not compete with any other sellers to these unique products.

CAP also operates another store at Amarillo Texas. It is called the "Parts Depot". Aircraft instruments, parts, rescue equipment are sold by mail again only to members or CAP units. These sales are at such a low price that this store operates consistently at a loss. It is intended that the "Parts Depot" be considered as a membership benefit to those CAP members who use their aircraft on CAP missions. It is also used by CAP units for parts for CAP aircraft.

Given the unique nature of CAP and its volunteer service to the country we submit that to include such store activities as unrelated business income subject to tax would be inappropriate and not be consistent with the purposes for which your committee is considering this legislation. We ask that appropriate exceptions be drawn to exclude CAP from such tax.

Carl S. Miller

CARL S. MILLER
B/GENERAL USAF (RET)
NATIONAL ADMINISTRATOR
CIVIL AIR PATROL
(205-834-2236)

April 13, 1988

Clarks Hearing Aid Service
921 Lake Land Blvd PO BOx 1159
Mattoon, IL 61938

Robert J. Leonard, Chief Cousel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Rep. Leonard:

This is in reference to reform of the Unrelated Business Income Tax(UBIT) system that applies to nonprofit organizations, specifically the concern of commercial hearing aid sales by nonprofit organizations.

I would like to urge you to apply the UBIT to all hearing aid sales income of nonprofits and also to encourage the Subcommittee to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

I operate my own business, and have been in business for 20 years. I am not afraid of competition, but I feel that it should be a fair competition. The nonprofit organizations that sell hearing aids but do not pay taxes isn't fair to businesses like mine who do pay taxes on our sales.

Sincerely,

Gene Clark #0078
Clarks Hearing Aid Service

Clarksville-Montgomery County
Historical Museum

P.O. Box 383
Clarksville, Tennessee 37040
Phone (615) 648-5780

April 8, 1988

Representative Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Representative Leonard:

I am writing in response to the options discussed by the Ways and Means Sub Committee on Oversight. Specifically delegated to the action of non profit's revenue-producing activities. The Clarksville-Montgomery County Historical Museum has an annual operating budget of $200,000. Through our efforts we raise approximately 50% of this income, the remaining 50% is donated by the City and County governments. My concern specifically deals with the option on gift shops and book stores, travel and tour services and royalty exclusions.

The option of the unrelated business income tax as it pertains to the sale of gift shop items through mail order business could directly effect our profit making abilities at the museum. As I understand this tax, if the items for sale do not have a emblem or logo that is directly related to the institution, then that item is subject to tax. At this time, all items we sell through the mail, deals with the history of Montgomery County, Tennessee or the South. None of these publications has the museum logo anywhere, and yet we are selling historical documents to state archives , libraries, historical societies and other museum shops throughout the entire Southeast. All of the items sold through the mail order business directly relate to the museum's statement of purpose, they are not non-historical, tourist related, gift shop memorabilia.

Another source of income for our museum are the trips we sponsor at an income-producing rate for our volunteers and members. For example, we chartered a tour bus to the Ramses Exhibit in Memphis this past spring. The interest and good will generated by this tour far exceeded the $400 profit we received for this organized trip. The unrelated business income tax would make these trips difficult for the museum to sponsor. Individuals who would not normally attend these tremendously historic events have now been given the opportunity. If this law goes into effect

"Our Heritage is a treasure,
Its Preservation a public trust"

we would have to curtail this service which includes several tour bus excursions in the near future.

Lastly I am concerned with the royalty exclusion, again directly involved with the unrelated business income tax. While our museum is no longer receiving a royalty, we at one time were for a book entitled Historic Clarksville. While the income from the sales was minimal, I am very concerned about our future prospects if this tax is applied to royalties.

As the President of the Tennessee Association of Museums I am aware of the more than 100 historic sites, museums and interpretative sites in the state. Ninety percent of these institutions have annual operating budgets less than $500,000, the majority in fact, are $100,000 or less. The unrelated business income tax as it pertains to the areas mentioned above would curtail activities in every museum in Tennessee. Many of these institutions, including my own, are working strenously towards being more self-sufficient and depending less on their governmental income. The type of tax being discussed by the Oversight Sub Committee would adversly effect our future growth potential. In no way has the Clarksville-Montgomery County Historical Museum strayed from its statement of purpose as an interpretative institution.

I sincerely hope you will weigh the adverse effect these tax issues will have on small non-profit institutions nationwide. We are already feeling the effects of reduced income by the new IRS laws and Graham Rudman. In order for non-profits to survive we need the support of the federal government. Without the tax laws remaining as they are many non-profits will face serious financial difficulties.

If I can be of further service or can answer any additional questions concerning this matter, please contact me at your convenience. Thank you for your time and consideration in this matter which will effect museums across the nation.

Sincerely,

Robert B Patterson

Robert B. Patterson
Director

RBP/mm

THE CLEVELAND MUSEUM OF NATURAL HISTORY

WADE OVAL, UNIVERSITY CIRCLE
CLEVELAND, OHIO 44106
(216) 231-4600

To: The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D. C. 20515

From: Dr. J. Mary Taylor, Director
Cleveland Museum of Natural History
Wade Oval, University Circle
Cleveland, Ohio 44106

Date: April 15, 1988

Regarding: The discussion option of the House Ways and Means Committee's Oversight Subcommittee on the "subtantially related" test of income-generating activities of non-profit organizations.

Our museum strongly opposes the option that would retain the "substantially related" test but explicitly treat certain activities as "inherently commercial." We believe that it would be unjust to view the activities of our museum sales shop as "inherently commercial." We view our sales shop activity as one of providing an educational enhancement to the experience of our museum visitors. Taxing sales shop income based on it being "inherently commercial" would threaten one of the few net income-generating activities that we have at our Museum.

Furthermore, we strongly oppose the threat to the tax-exempt status of any part of our program because we view it all as related to our charitable purpose and do not view any of it as being "inherently commercial." In no way do we create unfair competition for any of our local small businesses. Therefore, we believe that it is unjust to threaten any one of the few sources of income (including our museum sales shop) that we have to support our charitable mission.

The College Board
45 Columbus Avenue, New York, New York 10023-6992
(212) 713-8000

April 13, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
Washington, DC

Dear Congressman Pickle:

I am writing to express my opposition to the proposed legislation modifying the Unrelated Business Income Tax. This legislation would prove harmful to our organization for several reasons, which I will outline below.

Under this proposal, sales of educational materials through the mail will become taxable, even when a publication is written for such exempt purposes as providing guidance to students and their parents in the transition from high school to college. (This is the primary mission of the College Board.) The character of a publication does not change just because the sales are transacted away from our offices.

The term "routine testing income," which I suspect refers to laboratory testing, is vague in Section 1(H). If it refers to educational testing and assessment, the legislation would have an impact on almost everything the College Board was chartered to do by the New York State Board of Regents. I assume that this is not the intention of the proposed legislation and hope that the language will be tightened.

The proposed rule for allocation of costs is grossly inequitable. Why should a nonprofit be treated less fairly than a profit-making corporation? Prohibiting the allocation of a proportionate share of general overhead and prohibiting the depreciation of a facility housing an organization's operations are simply unfair. The income tax laws permit taxable entities to deduct all business expenses before the application of taxes.

The outcry of the small business community does not justify the rather drastic step taken by this legislation. I fear that the ultimate outcome of the proposed changes will be either to drive marginally operating nonprofit organizations out of business or to raise their costs significantly, which would require a higher level of public support. A much more sensible approach is for the Internal Revenue Service to properly enforce the current regulations, which are more than adequate to curb any existing abuses.

Sincerely,

Anthony J. Kearney
Vice President and Treasurer

AJK/kd

cc: Donald M. Stewart, President
Kenneth W. Rodgers, Executive Vice President
Lawrence E. Gladieux, Executive Director, Washington Office

A nonprofit educational association serving students, schools, and colleges through programs designed to expand educational opportunity

The Columbus Museum
P.O. Box 1617, Columbus, Georgia 31902 404 322-0400

April 12, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I am writing in response to the Committee's call for public comments on Discussion Options Relating to the Unrelated Business Income Tax.

I am gravely concerned about the consequences that some of the proposed options would have on the museum community, particularly the detrimental effects that would be visited upon the educational efforts of such institutions if these various options were to become law. As you know, federal dollars devoted to the arts and humanities are limited, and in recent years much emphasis has been placed upon the necessity for museums to seek other avenues of support. The proposed plan to change the UBIT seems to me to be an attempt to penalize those museums that have sought other means by which to generate revenue to support general operations. I cannot understand the mind-set that would seek to stifle efforts by museums both to fulfill their role as educational entities and to improve their financial situation, and consequently, their ability to serve their public audience.

The most ominous change options listed among your items for consideration concern gift shop and off-premise sales as well as royalties. At the heart of a museum's mission is its educational responsibility, and the interpretation of its collections is at the forefront of this concern. This is generally accomplished through exhibitions and, to the extent possible, through publications and/or objects. An exhibition catalogue for example, is the permanent record of a given project and generally has a lifetime of usefulness and accessibility far longer than the exhibit itself. Even so, the exhibit catalogue (perhaps dealing with one particular part of an artist's career) does not necessarily provide the complete story and context pertinent to that artist. Museums traditionally augment the sale of such specialized exhibit materials with related texts treating the subject more broadly and therefore providing the necessary contextual information that relates the exhibit material to its proper place within the grander scheme of things. These broader texts are as vital and pertinent to the understanding of the specific exhibit material as the exhibit catalogue itself. To tax income generated by the sale of such general texts is ludicrous, as it will discourage museums from offering them and thus serve as an anti-educational force.

Furthermore, I would like to point out that the application of UBIT to the sale of materials not directly related to a museum's collections (such as these general texts) will severely cripple small institutions in particular, many of which operate with limited resources, both in staff, budget, and collections. They must rely on the materials produced by larger institutions. For example, a small museum may own a respectable painting by Winslow Homer. The museum may not have the funds or the staff to publish a book on Homer but it certainly would be justified, and, indeed, obligated, to provide materials on this artist for its public audience. Perhaps there is no book available that discusses the particular Homer painting that the little museum owns, and general texts on Homer are the only alternative. It is quite conceivable that this same situation may exist for every book or object in that museum's gift shop--lacking the resources to produce materials on its own collection the museum must rely on related materials produced by others. Such situations under the proposed UBIT changes would create a great inequity among museums. Those with depth of collections and abundant resources would have shops well-stocked with related material and little taxation, while those with modest means, dependent on materials produced by others, would bear the burden of the UBIT.

In addition, the proposed changes affecting off-premise sales and royalties would further disadvantage small museums in that there would be a greatly reduced incentive for the larger institutions to make the materials they produce available to others. Here again the penalty would be visited most harshly upon the small organizations that can least afford it. Moreover, most museums exist in small to meduim-sized communities where educational materials such as are offered in their gift shops are not otherwise available to their public audience. In this respect museums fill a void in their local communities and this important service would fall victim to the UBIT if the proposed changes were to be implemented.

I am also concerned about the vagueness of the option regarding "convenience", as it is unclear what operations this would affect. I detected no mention of facility rental income and find it hard to believe that this aspect of revenue-producing activities has escaped the attention of the Committee, when other more clearly educational activities (such as book shops) have not. I would welcome some information in this regard.

In summary, I would like to emphasize my opposition to these proposed changes in the Unrelated Business Income Tax law. Museums are the guardians of our cultural heritage, and they should not be thwarted in their honest efforts to pursue their important mission with wisdom and integrity. They are so few in number and their financial impact on the small business community (which I understand is behind this movement to change the UBIT) cannot be great. In closing, I would urge the Committee to consider also the disservice UBIT changes would do to the general populace by both curtailing the general availability of educational materials and by reducing museum revenues, which will ultimately reduce educational activities offered to the public.

Sincerely yours,

Anne Timpano

Anne Timpano
Director

cc: The Honorable Richard Ray

AT/alr

OHIO
THEATRE
OFFICIAL THEATRE FOR
THE STATE OF OHIO
Columbus Association
for the Performing Arts

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Mr. Leonard:

I am writing to comment on the discussion options relating to the unrelated Business Income Tax released by the Subcommittee on Oversight of the Committee on Ways and Means of the U. S. House of Representatives on March 31, 1988. As President of The Columbus Association for the Performing Arts (CAPA), a non-profit, tax exempt, charitable, 501(c)3 corporation and Chairman of the International Society of Performing Arts Administrators (ISPAA) and Treasurer of the Ohio Citizens Committee for the Arts (OCCA), I have a working knowledge of the arts in America and I would like you to know that some of the options discussed in the Subcommittee's March 31st release would have a significant, unfair and undesirable effect on arts organizations across our country.

Arts organizations such as The Columbus Association for the Performing Arts, which owns and operates "The Official Theatre for the State of Ohio", the Ohio Theatre, cannot make our budgets balance on earned income alone; contributions/donations are the key to avoiding or diminishing deficits. Earned income often contributes only 60% of an arts organizations' total budget. The options the Subcommittee has proposed would be a tremendous blow to arts organizations which have succeeded in diversifying their earned income revenue base to protect and enhance the important mission they serve in their community.

Earnings on endowments sustain operations. Gift shops sell merchandise that helps spread the word about the arts organizations via t-shirts, coffee mugs and the like. Rentals of cultural facilities often enable audiences to become familiar with facilities they wouldn't otherwise visit, thus encouraging attendance at future arts events. T-shirts and key chains offer some incentive to prospective donors to contribute money to cultural organizations. Off-premise sales of tickets are critically important to expanding the reach of an arts organization to new audiences. Program book advertising allows arts organizations to provide detailed and scholary information to patrons about programs they are

55 East State St. Columbus, Ohio 43215-4264 614/469-1045

attending at no cost to the arts organization, an efficient and educational process. The income from these activities should not be taxed; they enable arts organizations to build audiences and stabilize operations in some of the few ways available to them as non-commercial interests.

It is my feeling that there is no good cause served by placing the precious cultural resources of this nation further in peril by preventing them from being able to enjoy the full financial benefits of such productive and necessary diversification. The Federal Government's inability to keep pace with the needs of the arts in America is evident in its failure to make the necessary increases in subsidy for the National Endowment for the Arts. The tax code has already been changed recently in a way detrimental to arts organizations when the charitable deduction was removed for non-itemizers in the 1986 tax law. Please don't handicap our most precious resource, the arts, further by approving tax code revisions which may be germane and necessary for other non-profit sectors but sweep the arts into its focus as well, whether inadvertently or purposefully.

Thank you for your consideration of this request.

Sincerely,

Douglas F. Kridler
President and
Executive Director

DFK/js

318

[redacted]

April 10, 1988

The Honorable J. J. Pickle
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Pickle,

I have just received word from the National Hearing Aid Society that you have released your preliminary findings on the reform of Unrelated Business Income Tax. I followed your subcommittee's hearings last June and want to commend you for your efforts.

This U. B. I. T. reform is long overdue and as a private businessman I am looking forward to your final recommendations.

I am in the hearing aid retail business. In the last five years, the expansion of not-for-profit dispensers in the Denver Market has reached 500%. Non Profit clinics are dispensing to the general public regardless of financial need. Hospitals that hold a non profit status are expanding their hearing aid sales at an alarming rate.

Their advantaged status allows them to compete at prices that would drive me out of business. The marketplace is being tampered with and the consequences to tax paying small businesses are profound.

I have not been able to see your recommendations. I have, however, been able to see the recommendations put forth by the minority members of your subcommittee. They were well thought out and would be a strong step in the right direction of resolving this situation. "Commercial" Non-profits have taken advantage of their privileged status and flaunted their exempt status like a halo at the unsuspecting consumer. Their function is not different from my own but they do not support the tax base that the private sector does. They abuse it and cause harm to those who must carry their share of the load.

I would like to address a few specific recommendations that I hope you will consider. I would like to have the "convenience" exemption for patients repealed or at least have the definition of patient restricted to "inpatients". Frankly, I feel that all hearing aid sales revenue should be considered as taxable under the U. B. I. T..

I represented our State's society in a local legislative effort to address this issue. I was surprised by the interest from other businesses.

A coalition was formed that had representation from Hearing Aid Retailers, Durable Medical Equipment, Veterinarians, Fine Arts Conservators, Travel Agents, Industrial Launderers, Athletic Clubs, Home Heath Care Providers, Nursurymen, Pharmacists, Ambulance Drivers and Private Transportation Providers.

In trying to find a resolution, we met with representatives from the Secretary of State and the Department of Revenue. Their response was specific. "This is a Federal problem. They must solve it. It is too large an issue for the State to handle. There are already Federal U. B. I . T. laws in place to deal with this." In short, they were not helpful. They did admit to having the laws in place to take action if needed. Unfortunately, they only follow or "piggyback" the I. R. S. efforts. Again the message is clear. If Federal action is weak, we could not expect a stronger effort from them on a local level.

The National Federation of Independent Business and the Colorado Association of Commerce and industry combined to help draft legislation to address this problem. It was beautiful! All areas were touched on. Privatization, Unfair Competition from State Agencies, Not-for-profits and Institutions of Higher Education and the establishment of a Private Enterprise Review Board. It did not last long.

Our sponsor was Representative Pat Grant in the House and Senator Les Fowler in the Senate. The Bill was gutted in the House subcommittee.

The Non Profit counter lobby got themselves totally written our of the law. They even got the study group removed to act as a data gathering group on this issue. They were a large impressive vocal lobby that had the clout to be heard. They also were terribly misinformed on our efforts and objectives.

As a private businessman, I know there is a need for the services of the Non-Profit sector. I donate and volunteer my time to help them. Our concern was only with the commercial activities that beyond the scope of their charter.

Their group felt that we objected to any of their activities and were trying to put them out of business. Based on this disinformation, they were successfully rallied to remove any mention of their group from the Bill.

Privatization fell in an Appropriations Committee. All we had left was unfair competition from State agencies and Institutions of Higher Education.

This has been passed by both Houses and we now await the Governor's signature. It may or may not be signed into law. We can only hope.

I not not mean to bore you with our local problems. I only want you to know that we are not idle complainers. We are trying to use existing resources to solve our difficulties. Our efforts will always fall short until Federal action is taken on the U. B. I. T.. That means your action Mr. Congressman. We need your help.

After five days of hearings in June, you know what we are dealing with. You are quite aware that there is a small minority of offenders that are the source of the problem. Their arrogance is unbelievable. Their tax advantage status creates a halo effect in the public's eye that can be exploited by a few "commercially" oriented Not-for-profit businessmen. We need your help.

Please use all means at your disposal to tighten the loopholes in the U. B. I. T.. Private business will compete fairly on an even playing field. If they want to enter this arena they must leave their tax advantage a the door.

This is not only a morally minded request, it is also an appeal to create more tax revenues by removing an exploited loophole in the law. We can use the help in both areas.

I will close by asking you to review the enclosed article from the Denver Post. It is not pertinent to the issue of unfair competition. It does, however, show the incredible arrogance we must contend with in Colorado. They refuse to cooperate with our own Legislators in providing financial records for J. B. C. investigations. If they can't break into their sacred tax forms. How can we be expected to. They are equally uncooperative with us. Their Health Sciences Center is also a major source of complaints on unfair competition in hearing aid dispensing.

Thank you for taking the time to listen to our complaints. I want to acknowledge your efforts and those who sit on your subcommittee.

Without your help, the system will continue to operate "business as usual". This is all the encouragement they need to expand their already aggressive efforts to destabilize the marketplace.

Sincerely,

Pat Davis

Pat Davis
Owner, Computer Hearing Aid Distributors
Former Owner, Custom Hearing Aid Co.

CU Foundation raises eyebrows of legislators

By John Diaz
Denver Post Capitol Bureau

In these lean times, it would be unrealistic for the University of Colorado to ask state legislators for luxury skyboxes at Folsom Field, a $700,000 mansion for the president or money for chancellors to spend on gifts and entertainment.

So where is CU getting the money for such things? From the University of *Colorado Foundation* Inc., a sophisticated, somewhat secretive and increasingly aggressive fund-raising agency formed by the Board of Regents in 1967. Its mission: to shake the alumni money trees and make those contributions go further through investments.

In two decades, the foundation has grown from a shoestring operation into a money machine taking in $25 million a year from donations and investments.

Now some lawmakers have questioned whether they should start considering the effect of those private donations when they draw up CU's $130 million annual budget. After all, they say, the university foundation's assets now exceed $80 million.

Foundation President Charles McCord argues that the organization was created to privately bankroll projects so they would not have to compete with other state needs.

Regents set up the foundation to allow an independent, professional group to solicit, collect and manage CU donations. "One of the things that tends to chill private support is government intrusion — or even the specter of it," McCord said.

Legislative auditors get a balance sheet from the foundation every year, but it gives few clues about how the foundation spends its money. And unlike most private foundations, the CU foundation does not widely distribute its detailed Internal Revenue Service disclosure forms.

The Joint Budget Committee three weeks ago asked for a detailed account of the foundation's discretionary funds — and still is awaiting a reply. That delay has frustrated the JBC, a powerful group accustomed to state bureaucrats working through the night to answer a request the next day.

The foundation's resistance to public scrutiny has been an irritant to some legislators, especially because alumni and other contributors receive tax deductions for donations made to the foundation.

"They should have to make a decision either to do away with their tax-deductible status or make an

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CU foundation grows into money machine

FUND from Page 1-A

accounting for the way the dollars are spent," said Rep. Jerry Kopel, D-Denver. "These are state institutions we're talking about."

Some of the foundation's financial dealings have blurred distinctions between private and taxpayer money.

Kopel

The university, for example, lent the foundation $500,000 from a Health Sciences Center parking fund when donations lagged for a 4,500-square-foot Italianate mansion for CU's president. The foundation received a preferential interest rate, with payments delayed until May 1990.

Faculty and administrative salaries are another area where the foundation's activities could affect legislative decisions.

Legislators know from sporadic disclosures that the foundation has sweetened CU staff paychecks, for example, by covering moving expenses, providing discretionary accounts for administrators, giving research money to faculty and even paying country club dues of a vice chancellor.

Private donations also cover salaries of special "chairs" — faculty positions set aside for academic stars who bring prestige and attract other high-caliber faculty.

But lawmakers don't know the extent of the fringe benefits or how it might skew CU's arguments that it needs salary increases or more instructors to compete with other institutions.

"We may very well look into that in the future," said Sen. Jim Rizzuto, a La Junta Democrat and JBC member. "We've thought of it, especially each year when they come in for funding . . . and one of the big things is salaries for instructors."

Under the current system, the foundation responds directly to wishes of regents or CU administrators. That means CU officials can get items they never could dream of asking from legislators. And they can get them much faster. The foundation has managed to put together such important projects for the university as:

- A $2.8 million renovation of the nearly 80-year-old Macky Auditorium, including six new opera boxes, improved lighting and sound systems and plush purple upholstery.
- The foundation will seek big-league contributors to fill 10 luxury skyboxes at Folsom Field. Construction of the skyboxes, atop a press box deck now used by photographers, is scheduled to begin in May. Cost has not been determined.
- A $20 million Health Sciences Center facility for cancer, brain and molecular biology research. The foundation has solicited donations for $3 million in seed money. Once completed, the facility would attract the equivalent of 50 or 60 small businesses in research activity, McCord said.
- President E. Gordon Gee and chancellors of CU's four campuses receive accounts to spend as they see fit. At the end of February, the high-ranking administrators had almost a total of $100,000 at their disposal.

The JBC's interest in the foundation stemmed from the disclosure that Dr. Bernard Nelson, the Health Sciences Center chancellor, spent $6,296 for an Aug. 25, 1987, going-away party for hospital director Robert Dickler. In a letter to Kopel, Nelson revealed the money for the party came from his "Chancellor's Gift Account."

"My reaction when I first heard about it was that it sounded kind of bad," said Sen. Mike Bird, a Republican JBC member from Colorado Springs. "But then *I* figured that if it's all private contributions, maybe we have to be a little bit flexible."

Tax records show other signs of the extent of the foundation's spending. Its salaries, office operating expenses and travel costs consume $4.4 million a year or 25 cents of every $1 donated; 25 foundation employees earn more than $30,000 a year each, with President McCord drawing $72,000.

As foundation officials and defenders see it, legislative oversight could only bring trouble. Sure, the foundation works on many glitzy projects for CU. But its proponents argue that it would be tough to get many of CU's 155,000 alums or wealthy "friends" excited about donating for a new boiler room or classroom furniture.

Gee

"Obviously, the projects people hear about are the ones you can tie a ribbon around and have a little bit of glitz," Gee said. "But when you realize that we're up to about $25 million a year, far and away the majority of that goes into the day-to-day academic enhancement programs. At the same time, you have to have some of the glitzy projects to create a catalyst for giving."

Rep. Elwood Gillis, JBC chairman, said of the foundation's assets: "We don't know where they get them. . . . We don't know the flow of their revenue."

But he said he would prefer lawmakers to leave the foundation alone, noting, "If we could raid those funds — or if we had any direction over them — we'd probably use them to make up for shortfalls at some of the schools."

The CU Foundation provides a balance sheet to state auditors every year. But unlike 200 or so other tax-exempt foundations, the CU group has not, for example, made its annual disclosure to the IRS available in public libraries or the state attorney general's office.

The foundation's current lack of accountability, Kopel argued, can breed jealousy and contempt. The Denver Democrat learned of the chancellor's $6,300 party from a medical school employee who was angry administrators would not spend a few hundred dollars for retirement parties for two rank-and-file workers.

"Like Caesar's wife," Kopel said, "we should avoid even the appearance of impropriety or favoritism — especially in our public institutions."

CORPORATION FOR PUBLIC BROADCASTING

1111 16th Street NW
Washington, DC 20036
(202) 955-5100

April 15, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office building
Washington, D.C. 20515

Dear Mr. Leonard:

The Corporation for Public Broadcasting appreciates the opportunity to provide comments to the Subcommittee's preliminary discussion options regarding the unrelated business income tax (UBIT). The Corporation is a private, nonprofit corporation, authorized by the Public Broadcasting Act of 1967 to develop noncommercial radio and television services for the American people.

While public broadcasting activities have not been the main focus of the Subcommittee's concerns, because the primary source of our funds is from contributions, CPB is concerned that some of the options presented by your Subcommittee would limit the ability of public broadcasting to raise the necessary revenue to serve the nation with the quantity and quality of programming for which we strive. It is for that reason that we are providing comments on specific areas of concern to public broadcasting.

First, I would like to support the option to increase the UBIT deduction to $10,000 and concur with limiting that deduction to activities directly carried on by the exempt organization. Public broadcasters should be included in this increased exemption. Increasing the deduction would encourage stations to develop new sources of income, as they were encouraged to do in the Omnibus Budget Reconciliation Acts of 1981 and 1985, in order to ensure that "public telecommunications as a source of alternative and diverse programming will be maintained and enhanced, and that public telecommunications services will continue to expand and be available to increasing numbers of citizens throughout the Nation." (Sec.1232. (a)(1))

CPB is very concerned with the proposed change in the treatment of royalty income. You have stated that exemptions will be retained for products that are part of the organizations' exempt function. Public broadcasters still should be able to claim exemptions for the distribution of their programs and the companion materials that support the programming. These activities are central to our efforts to provide not only educational programming, but also the printed materials that reinforce the programs.

A related concern is the distribution of items incidental to the solicitation of charitable contributions. The subcommittee has used the example of tee-shirts which state "I support public television" as one to which UBIT would apply under new regulations. Many public broadcast stations use this kind of station-specific item in connection with fund raising activities. Sale of items that assist public broadcast stations in fund raising is consistent with the aim of increasing public awareness of and participation in public broadcasting, and consistent with congressional mandate for public broadcasting to expand and diversify its sources of income. It is difficult, at current funding levels, to bring public broadcasting to all Americans and to maintain standards of high quality; direct activities of stations that increase the success of public broadcasting should be encouraged by remaining exempt from federal taxation.

Similarly, CPB opposes the option to repeal provisions of certain federal laws exempting certain gaming activities, games of chance and bingo games. Some states, faced with decreasing state revenues due to adverse economic conditions, cannot maintain support for public broadcasting at past levels. Those states and others that believe strongly in the value of public broadcasting services to their citizens have chosen to allow these stations to carry on gaming activities, with tax-exempt status. We support the efforts of those states to maintain funding for public broadcasting when state tax revenues become unavailable. We urge the Congress not to undermine the efforts of those states to support their public broadcast stations by taxing those revenues at the federal level.

CPB is making every effort to bring a strong public broadcasting service to all Americans, as cost effectively as possible. For the Congress to tax increasing amounts of locally raised income on related activities would impair broadcasting's ability to expand programming to the underserved and to maintain quality programming for Americans. We urge you to:

a. increase the UBIT deduction to $10,000 and ensure that public broadcasting is included in the new, higher limit;

b. ensure that public broadcasting retains exemptions for royalties from distribution of their education programs and companion materials that support the programs;

c. not to apply UBIT to the distribution of items incidental to the solicitation of charitable contributions;

d. not to repeal federal exemptions for gaming activities public broadcast stations utilize for fund raising when those activities are tax-exempt at the state level.

In closing, let me thank you again for the opportunity to comment on these important concerns CPB has with the options your subcommittee has presented. If there is any way in which we can help you by providing further evidence, please do not hesitate to call on us.

Sincerely,

Donald Ledwig

Donald E. Ledwig
President and Chief Executive Officer

COMMENTS
OF THE

COUNCIL ON NON-PROFIT ORGANIZATIONS

TO THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

CONCERNING
DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

April 15, 1988

The Council on Non-Profit Organizations ("CNPO") is pleased to present its comments on the discussion options relating to the unrelated business income tax, published by the Subcommittee on Oversight on March 31, 1988. CNPO is a national organization of charitable and other non-profit, tax-exempt organizations, dedicated to effectively serving the public interest through the diversity of the private sector and its flexibility in responding to the multifaceted needs of American society. In commenting on the discussion options, CNPO wishes particularly to direct the Sucommittee's attention to the adverse effects the options would have, if adopted, on charitable organizations.

While CNPO agrees that the Subcommittee should review the unrelated business income tax rules, many of the discussion options presented by the Subcommittee's Press Release #16, and the longer "Discussion Option" paper dated March 22, 1988, would reverse long-standing commitments by Congress not to tax exempt organizations' income from "related" activities and from investment-oriented, passive income-producing activities. These options appear not to be directed at correcting abuses identified to the Subcommittee in its hearings in June, 1987, but appear to be little more than an attempt to raise revenue from nonprofit organizations at the expense of the charitable and other activities -- long ago deemed worthy of tax-exemption -- they perform. Indeed, some of the discussion options would place exempt organizations in a worse position -- from an economic and competitive perspective -- than taxable organizations carrying on similar activities. This result, which goes far beyond even the original purposes and proposals of the taxable business community in asking Congress to review these rules, cannot be justified by any rational exempt organizations tax policy, and must be viewed as an attempt either to raise revenue or to simply drive exempt organizations out of certain legitimate -- and indeed necessary -- activities altogether.

This result would significantly disrupt the valuable exempt activities of many tax-exempt organizations, all the while raising, ironically, relatively little additional revenue for the Federal government. For example, in 1987, the Joint Committee on Taxation estimated that the proposal, passed by the House of Representatives, to tax the investment income of exempt organizations, would raise only $58 million over three years. The disruption and hardship caused by enactment of the discussion options is too high a price to pay for so little revenue, particularly when the non-financial value of the charitable activities that will have to be foregone is considered. The Subcommittee should, therefore, limit itself to recommending changes that respond to the real abuses identified to it, and that are clearly and fully justified by tax policy ("aside from the need of the [Federal government] for funds"). Treas. Reg. §1.513-1(a).

Indeed, some of the discussion options, such as those to disallow deductions of excess readership costs against net advertising income, or to disallow deductions for overhead, are directly contrary to sound tax policy because they would require accounting rules that are contrary to generally accepted accounting principles and that "do not clearly reflect income." I.R.C. §446(b).

One final concern that applies to nearly all the discussion options, even in the more detailed discussion of March 22, 1988, is the vagueness with which they are presented. In reviewing our comments and those of others, the Subcommittee and its staff must bear in mind that both the business and exempt organization communities find it difficult to comment on proposals whose precise scope and extent remain undefined. For this reason, we urge the Subcommittee, in future releases, to more clearly define the terms of its proposals. This is important both for purposes of receiving constructive and well-informed comments from all parties to the debate, but, even more so, for ensuring that whatever proposals are finally enacted are easily administrable by the Internal Revenue Service in a manner that will not engender unnecessary and ultimately counterproductive litigation that distracts exempt organizations from their beneficial works and creates unnecessary disagreement and misunderstanding between exempt organizations and the IRS.

With these concerns in mind, we turn now to our more specific comments on particular discussion options.

I. "Substantially Related" Test

In 1950, Congress determined that an exempt organization's activities must be "substantially related" to its exempt purposes in order for income from those activities to escape taxation. This test has generally served both taxable business and exempt organizations well. It is at once objective, taking into account the actual facts and circumstances of each case; flexible, adaptible to the changing circumstances of both exempt organizations and taxable businesses; and focused, enabling exempt organizations to pursue their charitable activities without fear of taxation, while placing them on a level competitive playing field with taxable business when they venture into non-investment activities not designed to further their exempt purposes.

In view of the fact that there has been no significant challenge to the "substantially related" test (as opposed to the IRS' administration of the test), CNPO believes it is inappropriate to change the test, particularly if the ways in which the "directly related" test requires exempt organizations to satisfy a more rigorous standard (than is required under the "substantially related" test), if that is in fact the intent of the proposal, remain unspecified.

The proposal to "[d]etermine whether each income-producing activity standing alone is tax-exempt" is not at all clear. If it simply restates the "fragmentation rule," adopted in 1969, of §513(c) of the Code and Treas. Reg. §1.513-1(b), it appears to make no change in present law. If it is intended to do more than this, its effects should be clarified so that meaningful comments may be submitted.

Specific activities

A. Gift shop/bookstore income

The proposal to tax income from sales by gift shops or bookstores operated by exempt organiztions narrows the IRS' current facts and circumstances approach to sales by museums, hospital gift shops, and university bookstores. It states, however, an overly narrow approach in two respects. First, it appears to tax sales of non-educational products that are otherwise related (religious, scientific, etc.) to the organization's exempt purpose. For example, churches and other religious organizations often operate a bookstore selling Bibles and other religious books that are unquestionably related to their exempt purposes, but that are not necessarily "educational." Similarly, a charitable organization may sell, at an on-premises gift shop, non-educational items manufactured by its handicapped trainees in the course of their rehabilitation. These items, non-taxable under current law, would be taxed under the proposal even though they are clearly "substantially" and "directly" related to the organization's exempt purposes. There can be no tax policy reason for this other than the raising of revenue.

In addition, assuming the items sold are substantially related to the organization's exempt purpose, there is no tax policy reason to justify taxing mail order sales, such as sales of religious books by church publishing houses and other religious organizations. Many denominations, for example, publish their own instructional material, virtually all of which is sold by mail or telephone orders to constituent members and congregations. Again, no tax policy justifies taxing these sales.

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J. Advertising Income and Cost Allocation Rules

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2. Advertising Cost Allocation Rules

This discussion option proposes to prohibit, for purposes of determining unrelated business taxable income, an exempt organization from deducting the excess of its readership (editorial content) costs over circulation income against any net income attributable to advertising. Under the present law, enacted by Congress in 1969, an organization may deduct any excess readership costs against any net income from advertising, thus reducing its unrelated business taxable income. By limiting, at deductions from advertising income to those costs incurred in generating the income, then allowing the deduction of any excess readership costs, sthe statute places exempt publishers on a par with taxable publishers, who may of course, deduct all costs incurred for both editorial and advertising purposes.

Despite the fact that there were few, if any complaints from taxable businesses about this rule, and its effect is clearly "neutral" as between taxable and exempt publishers, this discussion option would not only destroy that neutrality, but would place exempt publishers, particularly those who emphasize editorial quality to enhance their members' interest in their exempt purposes, in an economically and competitively worse position than taxable publishers. To do so in the complete absence of any tax policy justification or complaint from the taxable sector, and in derogation of generally accepted accounting principles, makes the proposal appear to be nothing more than an attempt to raise the amount of tax paid by otherwise exempt organizations, and it should be discarded forthwith.

II. Convenience Exception

In 1950, Congress enacted the "convenience" exception to the general rules defining an unrelated trade or business, to recognize that sales of unrelated products did not present any potential for unfair competition with taxable businesses when they were conducted in such a fashion as to satisfy needs of employees, students, patients, visitors, etc. that would otherwise simply go unfulfilled, rather than be satisfied by a purchase from a taxable business. For example, if a patient is unable to purchase a newspaper from a hospital gift shop, she is very unlikely to go to the corner newsstand to do so. Similarly, a university or other employee unable to purchase lunch at the employee's cafeteria or lunchroom may well decide to bring lunch from home rather than spend a valuable part of a lunch hour (or half-hour) leaving the campus or premises, to go to an off-site delicatessen to purchase a sandwich.

A second rationale for the convenience exception, applicable, for example, to museum cafeterias catering to museum patrons, is to enable the visitors to avoid the disruption of being required to leave the building to eat, then return (and perhaps pay a second admission fee) to complete their visit to the museum. The attraction of an on-premise cafeteria may, thereby, enhance the visitor's appreciation of the artistic activities of the museum.

While it is true that the IRS' administration of this rule has been criticized for not focusing enough on the availability of conveniently located alternate sources of supply, the rule itself remains a reasonable exception to the general rules. Where no reasonable potential for competition appears, no tax need be imposed.

III. "Regularly Carried On" Rule

Inherent in the definition of an unrelated trade or business is that it be conducted in a commercial manner. One aspect of that "commercial manner" is that the unrelated activity operated as frequently as similar taxable businesses. On the other hand, the IRS has long recognized that charities and other exempt organizations have historically raised funds through annual or otherwise sporadic and irregular events, such as the annual "fundraising gala event," Treas. Reg. §1.513(c)(2), and there have been few, if any, complaints about this rule. Thus, the proposal to narrow the rule to allow only "once a year" events seems to be directed principally at the IRS' maladministration of the rule, for it raises as many questions as it purports to resolve. For example, is a university alumni association's series of "annual" alumni balls in 25 cities across the country a "once-a-year annual fundraising gala?" Similarly, suppose the "event" is a fundraising drive stretching over two or three days, or a week, or a month.

Moreover, as suggested by the justification for the exception for annual events, activity that is only sporadically carried on (but more than "once a year") may not be a trade or business precisely because it lacks the requisite regularity that characterizes a trade or business.

IV. Royalty Exclusion

As noted in the discussion options memorandum dated March 22, 1988, present law excludes royalties from the definition of income from a trade or business This is one of several exclusions for "passive" income, including that received as dividends, interest, rent from real property, and annuities. In spite of the apparent retention of the exclusion for these latter forms of income, the discussion options propose to tax royalty income received by an exempt organization for licensing property created, developed, or marketed by it. This option appears to be an attack on organizations that license their name and other trademarks to taxable vendors such as credit card issuers, insurance companies, clothing manufacturers, and others.

This proposal is both ill-founded and counterproductive. First, there is no commercial activity by the licensor. By definition, once the license is in effect, the licensor is entirely passive in the marketing, selling, etc. of the product using the license (other than activities required to enforce the license, such as quality inspections and audits to determine the correct amount of royalties). See Rev. Rul. 81-178, 1981-2 C.B. 135 (Situation 2) (payment not a royalty when substantial services are required).

Second, much of the licensing activity that is conducted by exempt organizations is directed at increasing revenue from persons already interested in the organization. Thus, affinity credit cards and other licensed products or services are usually marketed principally (and often exclusively) to persons who are already members or donors, and thus more likely not to purchase the product at all if they do not purchase it from the licensee of the exempt organization.

Third, even when exempt licensors are competing with taxable licensors to license manufacturers or service providers, such competition is no different than that which already occurs with respect to commercial loans and other passive investments by exempt organizations. The only difference, an immaterial one, is that in this case the exempt organiztion is "investing" its intellectual property instead of its cash.

Fourth, far from driving taxable competitors out of business through unfair competition, a license from an exempt organization increases the costs of the taxable licensee (and nearly all licensees of exempt organizations are taxable), thus stimulating price competition by unlicensed competitors, and possibly increasing the tax revenue collected from those businesses.

In light of these problems, CNPO believes that the Subcommittee should reject both the broad attempt to tax the royalties of exempt organizations and the more specific proposal to tax income from endorsements of "affinity group" credit cards or fundraising sales from mail order catalogs. To the extent that these "endorsements" are cast as licenses requiring no activity from licensors, they should remain untaxed. Of course, if an exempt organization is performing substantial services in exchange for the royalty, the income from that activity is taxable under present law. Rev. Rul. 81-178, supra.

V. Deduction from Unrelated Business Taxable Income

Section 502(b)(12) allows exempt organizations a deduction of up to $1,000 against gross income from an unrelated trade or business. For this reason, exempt organizations whose gross income from unrelated activity is not more than $1,000 are not required to file Form 990-T. Treas. Reg. §1.6012-2(e).

CNPO agrees that after 38 years of inflation, the time has come to raise the specific deduction to at least $5,000. If this change is enacted, Congress or the IRS should also act to raise the filing threshhold commensurately. Failure to do so would impose significant recordkeeping and filing burdens on many smaller organizations whose gross income from unrelated business is between $1,000 and $5,000.

* * * * *

VII. Subsidiaries and Joint Ventures

A. Controlled Subsidiaries

Section 512(b)(13) taxes (to the extent the subsidiary's income would be unrelated if earned directly by the parent) the interest, rents, royalties, and annuities received by an exempt parent from a subsidiary as to which (if the subsidiary is exempt) the parent is able to control the appointment of 80 percent of the directors, or (if the subsidiary is taxable) the parent owns at least 80 percent of the voting stock and 80 percent of the shares of all other classes of stock.

This provision was added to the Code in 1969, to prevent tax-exempt organizations from spinning off a non-exempt activity into a subsidiary and then receiving payments from the subsidiary as rent, etc., that are inflated beyond the fair market value of the use being purchased. This practice, of course, would unjustifiably reduce the taxable income of the subsidiary through the payment of inflated tax-free income to the parent, which would otherwise

329

be payable only as dividend. Congress believed, however, that if at least 20 percent of the voting stock, or 20 percent of all other classes of the subsidiary's stock, were held by unrelated parties, the subsidiary's management would recognize the risk of violating their fiduciary duty to the outside shareholders and avoid agreements to pay above-market rents, interest, etc. The evil addressed by §512(b)(13) is not excessive control, but inflated payments. There is certainly no duty to avoid arm's length payments, and exempt organizations ought not be punished for dealing with their subsidiaries at arm's length.

No one who testified at the Subcommittee's hearings suggested that §512(b)(13) has been ineffective in "self-enforcing" Congress' concerns about inflated payments. In those unusual cases when such payments do occur, the IRS already has the tools required to treat the excess portion of the payment as a constructive dividend. Accordingly, CNPO sees no need for legislation reducing the control threshhold to 50 percent of the value or voting power of any one class of stock. Indeed, one possible result, to drive some unrelated activities back into the exempt organization, would contradict one entire focus of the Subcommittee, the need to more clearly define and separate exempt from non-exempt activities.

Another discussion option would treat an organization as a "controlled" subsidiary under §512(b)(13) when all tax-exempt owners of the enterprise own more than 50 percent of the stock or other ownership interests in the enterprise. This rule would unfairly tax minority shareholders who happen to be exempt if all exempt organizations own more than 50 percent of the stock, and "act in concert or with the knowledge of the others."

In addition to the basic unfairness of an otherwise unique rule effectively attributing ownership between unrelated parties, the quoted qualification is an invitation to litigation, and ought to be avoided at all costs.

B. Taxation of For-Profit Subsidiaries

For-profit subsidiaries of exempt organizations are presently taxed as any other taxable corporation: all expenses and losses from activities engaged in for profit may be deducted against all income and gains to determine the corporation's taxable income. A discussion option published by the Subcommittee proposes to prohibit a controlled subsidiary from deducting losses from activities related to the parent's exempt purposes against income from unrelated activities. The effect of this proposal is not to create a "level playing field" for exempt and non-exempt organizations, but to treat subsidiaries of exempt organizattions substantially less favorably than subsidiaries of taxable activities, again, in derogation of generally accepted accounting principles. This result cannot be justified by any tax policy other than to blindly treat dissimilar circumstances similarly, and must be rejected.

C. Aggregation

Another discussion option would aggregate the activities of an exempt organization with those of its controlled subsidiaries (including, presumably, any subsidiary in which it is a minority shareholder and that is "controlled" by unrelated exempt organizations) in determining whether the exempt organization continues to be primarily operated for exempt purposes. This proposal would effectively reverse for this purpose, the long-standing common law rule, applicable in tax cases, that parent and subsidiary (or other affiliate) corporations are treated as separate taxpayers for income tax purposes unless the Commissioner demonstrates that the dominant corporation exercised such complete control over the other as to make the other its agent or alter ego, having no independent purpose or activity. National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949); Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943). This doctrine has encouraged exempt organizations to establish for-profit subsidiaries to carry on unrelated activities, to avoid loss of exemption because the organization is no longer "exclusively" or "principally" operated for exempt purposes. Doing so ensures that all activities carried on by the subsidiary will be subject to tax even if some might have been justifiable as exempt activities in the parent. For this reason, and assuming the subsidiary is not simply the alter ego of the parent, there is no abuse to be cured by this discussion option. (Of course, current law is already adequate to cure any problem arising when the subsidiary corporation is merely the alter ego of the parent.) All of the income of the subsidiary is subject to tax, and no competitive advantage or loss of tax revenue exists. Accordingly, this proposal should also be rejected.

VIII. Allocation Rules

The Subcommittee's press release also proposes a discussion option that would, with respect to facilities used for both exempt and unrelated business activities, disallow any deduction for indirect expenses, such as overhead, that may presently be proportionately allocated to unrelated business income. This rule would be patently, unfairly, and unreasonably increase unrelated business taxable income by, again, treating exempt organizations worse than taxable entities. This proposal goes even further than the Government's arguments in Renssalaer Polytechnic Institute v. United States, 732 F.2d 1058 (2d Cir. 1984), in which the court prohibited the Internal Revenue Service from requiring Renssalaer to allocate indirect expenses on the basis of time available for use instead of actual use. The proposal also contravenes generally accepted accounting principles and ought to be rejected for that reason, as well.

* * * * *

X. Miscellaneous Options

A. Piecemeal Exclusions

(a) Distribution of low-cost articles. The IRS has for many years recognized that income received in connection with the distribution of low-cost articles is not income from an unrelated trade or business. Treas. Reg. §1.513-1(b). Because of confusion generated by United States v. Disabled American Veterans, 650 F.2d 1178 (Ct. Cl. (1981), aff'd and remanded, 704 F.2d 1570 (Fed. Cir. 1983), Congress codified and clarified the rule in §513(h)(1)(A), added by the Tax Reform Act of 1986. One of the Subcommittee's discussion options, coming less than two years later, would repeal §513(h)(1)(A). This may be unworkable for two reasons. First, a recipient has no obligation to pay for an article he receives by mail but has not ordered. Thus, the income received in response to such distribution cannot be said to be "from" the unrelated trade or business, but is legally a gift to the distributor. Second, many smaller organizations may be unable to identify the distribution as the source of particular contributions.

(b) Exchange or Rental of Mailing Lists

Disabled American Veterans also spawned the enactment of §513(h)(1)(B) by the 1986 Act, exempting income received by a §501(c)(3) organization for the rental or exchange of its mailing list to or with another charity. The discussion option proposing to repeal this provision is also problematic. Although lists are often said to be "rented," the IRS, prior to Disabled American Veterans, had consistently taken the position that the use of a mailing list was a right to use intangible property, a "license" generating "royalties," not a rental of tangible personal property (despite the fact that the intangible property may be embodied in a tangible item, such as a directory). Thus, charities may be able to exclude income received for the use of a mailing list under §512(b)(2), even if §513(h)(1)(B) is repealed.

Moreover, few charities license their active donor list to other charities, for fear of diluting its value. Usually, such a license involves inactive donors whose value to the licensor is substantially less than the value of the active list; thus, this proposal may raise little revenue.

* * * * *

(f) Convention and Trade Show Income.

There is probably no function of an exempt organization, be it a charity, civic league, labor union, or trade association, that is more central to its exempt functions than its annual convention and trade show. Here, members meet to conduct official organizational business (amending bylaws, electing officers, hearing annual reports, etc.), be educated about topics important to the organization's exempt activities and interests exchange information about current developments and new products and services, and otherwise corporately carry out the exempt purposes of the organization. To even suggest a "discussion option" that would tax the income from such a meeting as "unrelated" to the exempt purposes is shortsighted and ignores the careful thought which induced the Congress to specifically exempt this income from tax in 1976 and 1986.

Conclusion

The Council on Non-Profit Organizations thanks the Subcommittee on Oversight for this opportunity to comment on its discussion options relating to the unrelated business income tax. In our opinion, few of the proposals are justifiable by tax policies related to the exemption of charitable and other nonprofit organizations. Contrary to the avowed goal of the taxable business community -- parity -- a "level playing field" -- many of the discussion options would reverse any existing bias toward exempt organizations by inequitably treating them worse than taxable entities conducting similar activities. Some of these proposals would introduce arbitrary and artificial accounting rules not in conformity with generally accepted accounting principles and not clearly reflecting income. Other proposals would reverse Congress' historical commitment to enabling exempt organizations to freely earn and use investment income in the pursuit of their exempt purposes. Many would make changes in areas where no problem or abuse was identified or even suggested in testimony before the Subcommittee. Finally, a few are simply bald attempts to tax income from activities that are clearly and substantially related to an organization's exempt purpose. For these reasons, the discussion options addressed in these comments should be rejected.

Should the Subcommittee or its staff have any questions about CNPO's comments, please do not hesitate to contact Alan P. Dye, at 1747 Pennsylvania Avenue, N.W., Suite 1000, Washington, D.C. 20006; (202) 785-9500.

CORETECH COUNCIL ON RESEARCH AND TECHNOLOGY

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John G. Boyd
Treasurer
(I.B.M.)

April 15, 1988

The Honorable J. J. Pickle
242 Cannon House Office Building
Washington, D. C. 20515-4310

Dear Congressman Pickle:

As you know, the Council on Research and Technology ("CORETECH") was organized in early 1987 to represent a broad spectrum of the research community in connection with research and development issues which may be considered in the 100th Congress. In addition to the 45 corporations which are members of our group, we also have 79 educational institutions as members. (A copy of our current membership list is enclosed).

We are writing to you today to comment upon the discussion options which you listed in the press release issued by the Oversight Subcommittee on March 21, 1988. First, we were gratified to see that the list of options did not include a proposal to change the current tax-exempt status of both basic and applied research. Nevertheless, we were very concerned about the proposal to tax the royalty income which universities receive as a result of licenses that they give to private industrial companies who market technology which has been discovered through research at these universities.

CORETECH has been urging the Congress to improve and accelerate the so-called "technology transfer" process which refers to the transfer of technology from the research laboratories at an academic institution to the commercial marketplace. Interest in "technology transfer" and commercialization has been building during the past few years. We totally agree with the many commentators, both in and out of government, who have concluded that if the United States is to maintain its economic competitiveness, it has to strengthen its scientific base and improve its capacity to commercialize some of the technology being developed through research at our universities. With this goal in mind, CORETECH has stressed the importance of cooperative research in achieving technology transfer from the academic laboratory to the industrial marketplace.

1735 New York Avenue, N.W. Suite 500 Washington, D.C. 20006-4759 (202) 662-8407/03 Telex 904059 WSH Telecopy (202) 331-1024

Therefore, we were very concerned about the proposal to tax royalty income derived from the use of property created or developed by a tax-exempt organization. We urge the Subcommittee to reconsider this proposal, and if the Subcommittee decides to go forward with such a general rule, to at least consider an exception for royalties derived from these technology transfers.

Typically, industry and academia cooperate in the technology transfer in one of two different ways. One method is for the industry simply to acquire the right to further develop and market certain technology which has already been discovered by the university research. This is generally done through a license agreement, specifying certain royalty payments to the university. Another method would be for the industry to actually fund the academic researchers in the hopes that there might be a technological breakthrough with possible commercial application. In this instance, a contractual agreement for research funding is usually entered into with the understanding that if a technology breakthrough occurs, the industrial sponsor will have the first option to license and market the resulting technology.

The terms of the license, including the royalty payments, are negotiated at the time this option is exercised. Different institutions have different arrangements for division of the royalty payment, but in virtually all cases a portion goes to the individual researchers. This amount is, of course, taxable income to the individual recipient. The remaining portion is typically used to fund more research in the school generally or in the department specifically; to cover the cost of obtaining a patent; and to cover the cost of running the technology transfer program itself.

As you can see, the current proposal to tax royalty income derived from these technology transfers would be totally contrary to the government's efforts to encourage university research generally and to foster industrial cooperation with such university research efforts. The proposed tax would certainly be a disincentive to technology transfer and slow the commercialization of new and useful technologies, so vital to our international competitiveness.

As we understand it, one of the initial reasons for the Subcommittee's interest in the issue of unrelated business income tax (UBIT) of tax-exempt organizations was that the Subcommittee was concerned about unfair competition of tax-exempt organizations with small businesses. In our experience the small business sector has no complaints about these technology transfer programs. Indeed, many small businesses are the direct beneficiaries of such arrangements. Under P.L. 98-620, governing inventions made with federal support, the universities are required to seek out small businesses as licensees, and several of our member universities have reported that approximately one-third to one-half of their licensees are small businesses. The initial royalty payment by a licensee is frequently as low as $1,000, so it is easy to see how small businesses could take advantage of such a program.

In conclusion, we urge the Subcommittee to preserve the exemption of royalty income from taxation in the transfer of technology circumstances which we have described above. Thank you for your consideration.

Sincerely,

Joseph A. Saloom

Dr. Joseph A. Saloom
Chairman
Council on Research and Technology

The Council on Research and Technology

1735 New York Avenue, N.W. Suite 500
Washington, D.C. 20006
(As of 3/29/88)

COMPANIES (45)

- Abbott Laboratories
- American Cyanamid
- AMP, Inc.
- Analog Devices, Inc.
- Apple Computer, Inc.
- AT & T
- Bechtel Corporation
- Bristol Myers
- Cetus
- Control Data Corporation
- Cray Research
- Cullinet
- Digital Equipment
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- Genentech, Inc.
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- Tektronix, Inc.
- TRW Corporation
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- US WEST, Inc.
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- Warner-Lambert

UNIVERSITIES (79)

- Arizona Board of Regents
- Brandeis University
- Brown University
- California Institute of Technology
- Carnegie-Mellon
- City Univ. of New York Research Foundation
- Clemson University
- Cornell University
- Dartmouth College
- Drexel University
- Duke University
- Emory University
- Georgia Institute of Technology
- Harvard University
- Indiana University
- Iowa State University
- Johns Hopkins University
- Kansas State University
- Lehigh University
- Massachusetts Institute of Technology
- New Mexico State Univ.
- New York University
- North Carolina State
- Northern Illinois Univ.
- Northwestern University
- Ohio State University
- Oregon Ctr. for Advanced Technology Education
- Oregon Graduate Center
- Penn State University
- Princeton University
- Purdue University
- Rice University
- Rensselaer Polytechnic
- Rockefeller University
- Rutgers University
- Southern Illinois Univ.
- Stanford University
- State Univ. of New York at Buffalo
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- Texas Tech University
- Tulane University
- University of Alabama Birmingham
- University of Alabama System
- University of Arizona
- University of California System
- University of Chicago
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- Utah State University
- Vanderbilt University
- Virginia Commonwealth Univ.
- Virginia Tech
- Washington State Univ.
- Washington University
- Wayne State University

PUBLIC AND PRIVATE ASSOCIATIONS (16)

- ADAPSO, Inc.
- Association of American Universities (AAU)
- American Electronics Association (AEA)
- Association of Independent Research Institutes(AIRI)
- Computer Business Equipment Manufact. Assn. (CBEMA)
- Council on Govt. Relations
- Electronic Industries Association (EIA)
- Motor Vehicle Manufacturers Association (MVMA)
- NASULGC
- National Association of Manufacturers
- National Machine Tool Builders Association
- National Printing Equipment and Supply Association
- Oakridge Associated Universities
- Pharmaceutical Manufacturers Association (PMA)
- Scientific Apparatus Makers Association (SAMA)
- Semiconductor Industry Association (SIA)
- Southeastern Universities Research Assn. (SURA)

RESEARCH INSTITUTES (7)

- Battelle Memorial Research Institute
- Bell Communications Research
- IIT Research Institute
- Houston Area Research Ctr.
- Microelectronics & Computer Technology Corporation
- Nat. Biomedical Research Foundation, Inc.
- Research Triangle Institute

AFFILIATES (7)

- American Society for Engineering Education
- Bell Atlantic
- Council on Competitiveness
- NEC America, Inc.
- New England Council
- Ohio University
- University of Rhode Island

COYOTE
POINT
MUSEUM
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Linda Liebes

April 13, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Bldg.
Washington, DC 20515

Dear Chairman Pickle:

Attention: Robert J. Leonard

Re: Unrelated Business Income Tax

I am writing on behalf of Coyote Point Museum Association, a non-profit organization which operates Coyote Point Museum, to protest the projected changes to the substantially related test.

Coyote Point Museum provides a public service to over 140,000 people annually at minimal cost to the taxpayer. This is because our volunteer Board, Auxiliary, Docents and President's Council which number over 400 people contribute 9,000 hours annually to operate and raise funds for our museum.

In addition to direct fund raising, we obtain a portion of our income from earned revenue sources, such as admission fees and proceeds from a small museum store, operated by our volunteer Auxiliary.

This store is operated as an educational extension of the museum and nets a modest $12,000 annually. If it were not operated by volunteers, there would be no profit. We are not in competition with local businesses and do not pose a threat to them.

If the small income from store sales were taxed, the costs involved in administering the program would outweigh the benefits. In addition, our museum which is struggling to raise funds would be hurt further by a fiscal policy which should encourage volunteerism and provision of a public service at no cost to the government, not penalize it.

We urge you to find other ways than taxing non-profits to obtain revenue.

Sincerely,

Linda Liebes

Linda Liebes
Director

cc: Congressman Tom Lantos

Coyote Point, San Mateo, California 94401-1097 • (415) 342-7755

Cross-Cultural
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518 South Agassiz Street
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USA
(602) 774-8108

12 April, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Attention: Subcommittee on Oversight; Honorable J.J. Pickle, Chairman
Comments on Discussion Options Relating to the Unrelated Business Income Tax

We are a small non-profit organization that exists on the revenue from memberships; donations; volunteerism; and the sale of a book that was given to us by the author for this purpose. We are preparing applications for grants, but any awards are still in the future.

Although we are small, we have expenses to maintain a building facility with a library, archives, movement space; occasional community events; a twice-yearly professionally prepared and printed newsletter; and an international correspondence/consultation concerning dance research. In short, we must accomplish much on a very limited income and we need every tax break possible in order to continue our existence.

We implore you to not raise taxes or in any other way curtail operations of non-profit organizations' revenue-producing activities. The sale of the book, for example, has many times provided the only income we have had; without those sales we would not have been able to operate.

Thank you.

Sincerely,

Joann W. Kealiinohomoku

Joann W. Kealiinohomoku, Ph.D.
President, Board of Directors

Enc.: original plus six (6) copies

ADVENTURES IN DISCOVERY
800 Ridley Boulevard
Nashville, Tennessee 37203-4899
(615) 259-6099

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House, Office Building
Washington, DC 20515

Dear Mr. Leonard:

This letter is in response to your request for reactions to the Subcommittee discussion options specifically:

1) Repealing "substantially related" test.
2) Apply UBIT to travel programs.

We object strongly to both proposals because:

1) Both our Museum Sales Shop and Travel Program are extensions of our educational goals, as they provide for learning to continue beyond the walls of this museum. Our mission is informal education so books, fossils, etc. as well as educational trips are part of our informal learning opportunities.

2) They produce income needed to help us undertake the full scope of our mission. What sense does it make to diminish one more source of revenue for our museum while at the same time recognizing our importance to our society by retaining other non profit tax exemptions.

I am sure most of our 8,000 family members and 60 Board of Trustees would agree with me if we had time to poll them.

Sincerely,

Bill Bradshaw

William Bradshaw
Executive Director

cc to : Representative Bob Clement

lg

CUMBERLAND SCIENCE MUSEUM

The Currier Gallery of Art

192 Orange Street Manchester, NH 03104 603 / 669-6144

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Sir:

Your call for public comment on the UBIT "discussion options" prompts me to respond on behalf of New Hampshire's major museum, The Currier Gallery of Art. The Gallery would experience a significant reduction in revenue if certain of those options are adopted.

Our museum shop sells only fine art reproductions and books. Because we are a small institution, we cannot ourselves produce many of these items, and purchase publications from other institutions. While not "directly" relating to our own collection, the items we do sell enhance our visitors understanding and enjoyment of the museum. Changing the legislation concerning off-premise sales would lead to a substantial increase in the wholesale prices of our inventory.

We also offer a series of art related travel tours for our members. While we do not offer college credit for these trips, they are carefully designed to be educational. These tours provide our members an opportunity to study the arts in depth, under the guidance of qualified staff; they are in no way "sight-seeing" tours, and we do not compete with the travel/tour industry.

In a time in which museums are forced to seek new sources of revenue, we ask that you consider the detrimental impact of such legislation. The affected revenues are the very funds that enable the museum to serve the people of our state with exhibitions, educational programs and the maintenance of our permanent collection.

Sincerely yours,

Kathy L. Jean

Kathy L. Jean
Business Manager

DA CAMERA
SOCIETY
SERGIU LUCA • DIRECTOR

April 15, 1988

Honorable J.J. Pickle, Chairman
House Ways and Means Subcommittee on Oversight
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Pickle,

I am writing to express opposition to the proposed changes in UBIT proposed by your subcommittee as they apply to non-profit organizations.

As the manager for a non-profit arts organization in Houston, I have found that the activities in which your subcommittee is interested are mainly used by not-for-profits to increase their income as they pursue their activities focused on improving the cultural, educational, or civic amenities focus of their communities. As tax laws have changed, and as the current Administration has exhibited lassitude (if not hostility) towards the arts communities by setting a tone for the for-profit sector in which they feel justified in reducing their contributions, non-profits have responded creatively to increase their income so as to maintain their reach. Without that incremental income, based on activities associated with the organizations' purposes, these organizations are forced to reduce the scope of their activities, activities which the government is unable, or unwilling, to supply.

Further, your proposals to increase the reporting requirements could be better focused. Should there be those organizations that abuse their non-profit status the laws already exist to police them; the answer is better policing. Increasing reporting requirements strongly increases the burden on all when the target is a very few. Given the straitened levels of staffing at which most non-profits operate, staffing that is usually not even adequate to properly perform their current functions, adding further loads can only further limit the acknowledged good these organizations perform.

On behalf of my organization in Texas, and other arts organizations across the country, I would urge your subcommittee to not further limit the ways in which non-for profits can reduce their deficits. I would even go so far as to urge you to focus instead on how non-for-profits can increase their funding levels so as to better serve their communities.

3912 MANDELL, HOUSTON, TX 77006 • (713) 524-7601

Cordially yours,

Jesse Ira Berger
Manager/Operations

Dallas Museum of Art

April 11, 1988

The Honorable J. J. Pickle, Chairman
U. S. House of Representatives
Washington, D. C. 20515

Dear Representative Pickle:

I am writing to you with regards to the proposed changes in unrelated business income tax guidelines for nonprofit organizations and the implications of such actions on the Dallas Museum of Art. It is the stated purpose of the Dallas Museum of Art to"acquire, conserve, and exhibit the art of mankind to present and future generations for their enjoyment, education and inspiration, and in doing so, enhance the quality of Dallas' cultural environment." All revenue generated by our organization is applied toward this objective. Taxation on gift shop income, food sales, catalogue and mail/phone order sales, and royalties would be extremely detrimental to our abilities to maintain a balanced budget and sufficiently support our educational programming. Consideration of such taxation is particularly troublesome at this time given the depressed economic climate in Texas. City, state, and federal support for the majority of cultural institutions continues to decline and we must depend more and more heavily on our auxiliary activities to fill this gap. Taxation to these activities would be a significant blow. I would ask that you reconsider these measures.

Sincerely,

Jean Folwell
Director of Finance and Administration

cc: Robert Leonard, Chief Counsel, Committee on Ways & Means

1717 North Harwood Dallas, Texas 75201 214 922-0220 Telex 294 369 DMA UR

April 12, 1988

The Honorable Robert J. Leonard,
Chief Counsel - Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

Subject: Unrelated Business Income Tax (UBIT) system that applies to nonprofit organizations.

I wish to commend the subcommittee for proposing an excellect package of reform measures. Be sure to include all these reform measures in your final report.

It is very important that you apply UBIT to all hearing aid sales income of all nonprofit organizations. Some examples of nonprofit organizations are Universities, Hearing & Speech Centers, and Hospitals. Hearing aid sales by these nonprofit organizations are actually commercial in nature and competing directly with our business. This is really unfair since we pay taxes on our income from hearing aid sales, but the nonprofits go scott free when it comes to taxes. Another straw that breaks the camel's back is the fact that United Way supports United Health Services (Hearing & Speech Center) which is located two blocks from our office. This means the Hearing & Speech Center has a 2-fold chance to reduce their prices in competing with our prices. First, the public supports them through United Way and all of us support them by our government's failure to tax them. I am referring to:

United Health Services
Hearing & Speech Center
711 E. Colfax Avenue
South Bend, IN 46617

Barbara Rockaway, Executive Director
Phone 219-234-3136

Another example of unfair competition in our area is:

Andrews University Speech & Hearing Clinic
Bell Hall, Rm #162
Berrien Springs, MI 49104

Director: Jean Maki
Phone 616-471-3468

They operate under the guise of providing training for their students in audiology and fitting of hearing aids - not for profit. The hearing aids are purchased through a wholesaler in Kalamazoo and paid for directly by the client to the wholesaler. In this manner the clinic does not legally sell the hearing aid even though they are involved in the testing, fitting, etc. The reason I point this out is because they can test, recommend, and fit hearing aids to Medicaid patients with the blessings of Michigan Dept. of Public Health.

Sometime ago I questioned why they could perform the complete procedure and was told it is possible because the hearing aid is sold by the Kalamazoo Wholesaler and not the clinic. Michigan Medicaid policies call for one facility completing the testing and making recommendations to a 2nd party or firm who completes the fitting.

Remember, by allowing the nonprofits to compete unfairly against small for profit organizations, you are breaking the back-bone of this country - SMALL BUSINESS! If you want unemployment to increase, then you should disregard my comments.

Thank you for bearing with me on this important issue.

Sincerely yours,

Chester R. Mischke

Chester R. Mischke, BC, NBC - HIS
Board Certified by Hearing Instrument Sciences
Certified Hearing Aid Audiologist by N.H.A.S.
Licensed as a Hearing Aid Dealer in Michigan and Indiana
President - Darr & Associates, Inc.
2932 Niles Ave.
St. Joseph, MI 49085

(Identical letter received from David Wenger, Vice President, Darr & Associates, Inc., South Bend, Indiana.)

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SAE

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Director
Registered Professional Engineer
Massachusetts
Province of Ontario, Canada
Member
IEEE
IEEE EMC Society

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard,

The purpose of this letter is to outline our concerns regarding competition from non profit organizations. Our firm is a test laboratory which tests electronic data processing equipment for compliance with Federal requirements. These include regulations governing radio interference, electronic product safety and regulations which insure that such equipment does not harm the telephone network. These standards are set by the Federal Government. Radio interference is regulated by the FCC (Part 15, Subpart J). The FCC also regulates connection of equipment to the telephone network (Part 68). OSHA, in Part 1910 Subparts of its rules, makes "listing" of electrical products used in the workplace mandatory.

The use, and abuse, of provisions regarding non profit organizations is threatening my company. Chiefly, it is Underwriters Laboratory, operating under a provision providing for "testing for the public safety" that has given unfair advantage over me. That, combined with other federally granted largess, has made UL nearly impossible to compete with, as I shall explain.

First, UL is currently granted a virtual monopoly status by two federal agencies, OSHA and GSA. Both require UL or Factory Mutual (FM) listing of electrical products used in the workplace or purchased by the government respectively. Both agencies have been requested to provide, but have denied, other laboratories such status [1].

NVLAP

* Accredited by the National Bureau of Standards for Emissions and Telecommunications Testing
Approved by the Canadian Dept. of Communications for Telecom Testing
Recognized by the United Kingdom National Measurement Accreditation Service
Recognized by the New Zealand Testing and Registration Council
Recognized by the Australian National Association of Testing Authorities

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‡ After July 16, 1988

UL is therefore given a federal sponsored monopoly status (along with FM) for product safety testing. The tax code further exempts UL from tax, making their monopoly profits tax free.

Not satisfied with these sources of revenue UL has sought out new markets. As part of this effort UL has targeted my business for competition. They now have begun testing products for telecom and emissions compliance (FCC rules Part 15 and 68) and have been heavily advertising that effort.

I cannot compete with UL. They are given a monopoly in product safety testing. Now their monopoly profits are being used to move into my business. (UL weakly claims that these areas are safety related and therefore within their tax free scope. They clearly are not. This is proof enough that the standard "testing for product safety" is too vague).

I have attached an advertisement that UL has published regarding their services that compete with mine. There is also a revealing article published in the Wall Street Journal.

As a small business, I cannot afford the kind of lobbying which created and maintains these preferences for UL. I must appeal to your sense of justice, and pray that alone is enough.

Sincerely yours,

Glen Dash
Dash, Straus & Goodhue, Inc.

GD/in
a:usrepdc.11

Footnote [1] Finally, in December of last year, the US District Court for Maryland ordered OSHA to reform its regulations. GSA has not, however, reformed theirs.

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PAGE 25
MONDAY, NOVEMBER 10, 1986

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THE WALL STREET JOURNAL.

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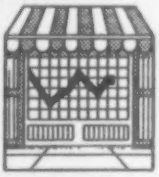
SMALL BUSINESS

Small Labs Chip Away at UL In Market for Product Testing

By STEVEN P. GALANTE
Staff Reporter of THE WALL STREET JOURNAL

UNDERWRITERS LABORATORIES INC. is to product safety testing what American Telephone & Telegraph Co. used to be to phone service. The UL symbol is ubiquitous, stamped into the bottoms of toasters, molded into TV cabinets and printed on tags clinging to extension cords. In the testing of consumer products, UL has long held a near monopoly.

But, just as with AT&T, UL's dominance is starting to diminish. Several privately owned testing laboratories have begun to nibble at UL's market. Using the traditional strategies of small-business operators—better service and lower cost—they are capturing a growing share of the safety-testing business. "UL no longer has a monopolistic grip on the market," asserts Jordan V. Sukert, owner of Applied Research Laboratories Inc. in Miami.

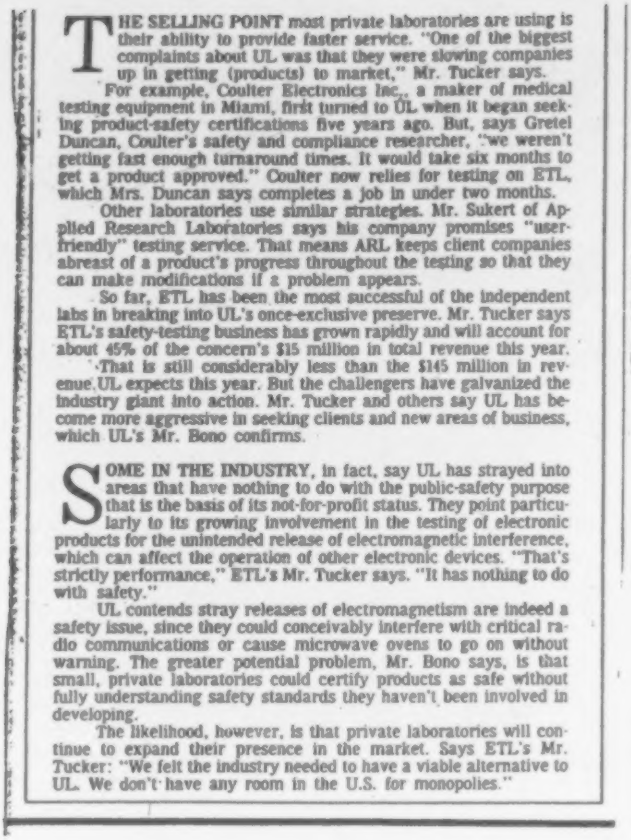


The intensifying competition may benefit small manufacturers and consumers by bringing products to the market faster and cheaper. But it also raises questions about the integrity of product testing done by small, profit-driven laboratories with less equipment and experience than UL, a not-for-profit corporation based in Northbrook, Ill. "We're a little concerned that products may get into the marketplace that do not meet national (safety) standards," says UL President Jack Bono.

WHY SMALL LABORATORIES want to get into the safety-testing market is clear enough. The business has been growing at an annual clip of at least 15% in recent years. Behind the growth are a proliferation of new kinds of products, mostly electronic gadgets, an explosion of product-liability suits, and deregulation, which has turned inspections of many kinds of products over to private industry. Testing "is probably one of the fastest-growing businesses that exist today," says Leonard Frier, president of MET Electrical Testing Co. in Baltimore.

The challenge for MET and other privately owned laboratories has been to establish themselves as credible alternatives to UL. That is no mean feat. More than 2,700 state, city and municipal governments in the U.S. require safety certifications on certain products sold or installed in their jurisdictions. To establish credibility, a laboratory must win recognition from at least the 125 or so biggest jurisdictions. Moreover, the labs must persuade many municipalities to rewrite regulations that require their safety testing to be done specifically by UL.

The small laboratories, with increasing success, have struggled to change those rules. But even then they must convince skeptical manufacturers that retailers and consumers will accept their unfamiliar logos over the UL symbol. "UL has become almost generic when it comes to product safety," says James W. Tucker, president of ETL Testing Laboratories Inc. in Cortland, N.Y. "It's almost like Kleenex or Xerox."



THE SELLING POINT most private laboratories are using is their ability to provide faster service. "One of the biggest complaints about UL was that they were slowing companies up in getting (products) to market," Mr. Tucker says.

For example, Coulter Electronics Inc., a maker of medical testing equipment in Miami, first turned to UL when it began seeking product-safety certifications five years ago. But, says Gretel Duncan, Coulter's safety and compliance researcher, "we weren't getting fast enough turnaround times. It would take six months to get a product approved." Coulter now relies for testing on ETL, which Mrs. Duncan says completes a job in under two months.

Other laboratories use similar strategies. Mr. Sukert of Applied Research Laboratories says his company promises "user-friendly" testing service. That means ARL keeps client companies abreast of a product's progress throughout the testing so that they can make modifications if a problem appears.

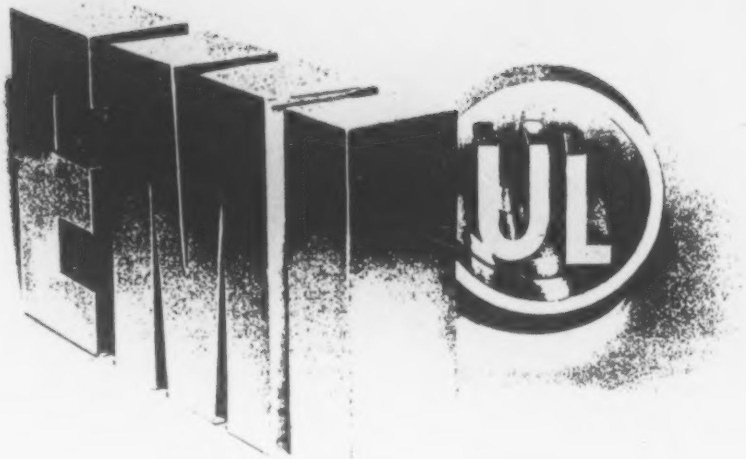
So far, ETL has been the most successful of the independent labs in breaking into UL's once-exclusive preserve. Mr. Tucker says ETL's safety-testing business has grown rapidly and will account for about 45% of the concern's $15 million in total revenue this year.

That is still considerably less than the $145 million in revenue UL expects this year. But the challengers have galvanized the industry giant into action. Mr. Tucker and others say UL has become more aggressive in seeking clients and new areas of business, which UL's Mr. Bono confirms.

SOME IN THE INDUSTRY, in fact, say UL has strayed into areas that have nothing to do with the public-safety purpose that is the basis of its not-for-profit status. They point particularly to its growing involvement in the testing of electronic products for the unintended release of electromagnetic interference, which can affect the operation of other electronic devices. "That's strictly performance," ETL's Mr. Tucker says. "It has nothing to do with safety."

UL contends stray releases of electromagnetism are indeed a safety issue, since they could conceivably interfere with critical radio communications or cause microwave ovens to go on without warning. The greater potential problem, Mr. Bono says, is that small, private laboratories could certify products as safe without fully understanding safety standards they haven't been involved in developing.

The likelihood, however, is that private laboratories will continue to expand their presence in the market. Says ETL's Mr. Tucker: "We felt the industry needed to have a viable alternative to UL. We don't have any room in the U.S. for monopolies."



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(202) 879-3241

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to you on behalf of the Daughters of the American Revolution Museum in Washington, D.C. We are quite concerned about the proposed changes in the Unrelated Business Income Tax for tax exempt organizations.

The National Society Daughters of the American Revolution is tax exempt. The Museum, which has a small gift shop attached to it, is primarily a historical museum with emphasis on the decorative arts of America before 1850. We are open to the public all year round and have a substantial outreach program to the area schools. In 1987, 58 schools with 3320 students took tours through the Museum. Over 20,000 visitors and 89 organized tours came to the Museum. Because of NSDAR tradition, the Museum is not allowed to apply for or accept grants which would help us keep our doors open.

The Museum Gift Shop revenues contribute to the mounting of exhibitions and daily maintenance of the Museum. Without the Shop, the Museum would suffer greatly.

We attempt to keep the merchandise sold "substantially related" to the collection. However, if the range of items were to be reduced so that they were "directly related," we feel that the service we provide to the public would also be diminished. For example, our collection of decorative arts includes: furniture, silver, ceramics, paintings and textiles. In other words, the Museum highlights the craftsmen of Colonial America and is successful in stimulating its visitors to learn more.

But, under the new options, we would not be able to sell our books on the individual decorative arts. We would not be a source of information for those interested in learning about needlework, quilts or toys. Furthermore, our stationery, which bears some of the quilt designs in our collection, would be lost even though a description of historical importance is printed on the back of every card.

Another area of concern to the Museum is the possible loss of mail order income. This is, at present, only a small source of income for us but we had hoped to expand it in the future. Because we are forbidden to seek grants, we depend on contributions from our members, the majority of whom live in other parts of the country. The sale of Museum items through the mail order catalogue is a dependable source of revenue.

In conclusion, we feel that any of our business income which may be categorized as "inherently commercial" in the future is only profitable for the Museum and the museum-going public. The Gift Shop has no financial function other than support of the Museum's public outreach and does not threaten the business community in any way.

Sincerely,

Catherine Tuggle

Catherine Tuggle
Museum Business Manager

dca EDUCATIONAL PRODUCTS INC.

April 12, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

Thank you for the opportunity to submit comments concerning the discussion options regarding the Unrelated Business Income Tax. The options as they appear in Press Release #16 of the subcommittee are quite complete and offer the type of relief that those of us in the business community have sought for many years.

Chairman Pickle and his subcommittee have done an excellent job in analyzing the evidence presented to them during the hearings held in June 1987. Their summation of the options for discussion is well done.

In particular I support that portion of I.A. which states, "In addition, apply UBIT to income from all catalog and mail/phone orders or other 'off-premise' sales (with exception for de minimis sales, in relation to amount of 'on-premise' sales)".

Most of my company's "non-profit" competitors sell via catalogs distributed using the "non-profit" postal rates; but they offer materials similar to that which I and my business competitors have long offered.

I also support IV. which applies to Tax Treatment of Royalty Income. Some universities cover their profits by using an agent or dealer to sell their product. The agent or dealer then submits payment in lieu of royalty as a quasi charitable contribution. In reality, the money is profit from sales and should be treated as taxable income.

The business community came to the hearings well prepared. We stated our case in the proper form, then returned home to continue running our individual businesses in the ways that we know best.

Because the "not-for-profit" sector failed to present a legitimate case, or at least failed to present it well, they found it necessary to do very extensive and expensive personal lobbying during the ensuing months. Were those lobbying dollars available because they did not have to consider "profits"?

I started collecting information concerning "not-for-profit" competition as early as 1974 and presented it at a Small Business Administration hearing in Des Moines in August 1979. The pioneering efforts of those at that hearing provided the push that brought about the hearings in June, when Jerry Brong, speaking for the International Communications Industries Association, made an able presentation of the problems we face.

Since the hearings, we have not seen any change on the part of our "not-for-profit" competitors. It will only be through the enactment of legislation based upon the work of the Oversight Subcommittee that business will be able to obtain appropriate relief from the "not-for-profit" sector.

More power to you!

Yours truly,

DCA EDUCATIONAL PRODUCTS, INC.

Bennett V. Schultz
President

BVS:ag

DENSON HEARING CENTER
Michael J. Denson
736 South Michigan Avenue • Howell, Michigan 48843
(517) 546-7456

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

April 08, 1988

Dear Chief Counsel Leonard,

Please include this letter in the request for Public comment regarding commercial Hearing Aid Sales by non-Profit institutions.

I feel the Unrelated Business Tax for non-profits is long overdue. My business has not only been hurt by loss of income but also by long term loss of integrity in the community regarding hearing aids and services. Those who have attempted to compete in my area via non-profit have destroyed and confused a very clear organized delivery system for products and services. In the hearing assistance business this is very detrimental to those with hearing problems. We must practice only the finest quality and standard in this field in order to help an epidemic problem in the United States.
Had these non-profit institutions based their business methods on the success (profits) of their operation, inevitably they would have closed.

It is not fair that our tax money should franchise any government loss programs within our country. Bad policy at least.
Please apply UBIT to all hearing aid sales and services income of non-profits and repeal the existing convenience exemption for patients or recognize patients as inpatients only.

Truly Concerned in Our Future,

Michael Denson

Michael J. Denson
Board Certified
National Board for Certification-Hearing Instrument Sciences

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12 April 1988

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

Subj: UBIT

As a small businessman I wish to commend the Committee for its work to reform the Unrelated Business Income Tax system as it applies to nonprofit organizations.

This has special impact in this area because several hospitals are considering the direct sale of hearing aids to individuals both inside and outside of the hospital. One aspect of this that you may not have considered is that some hospitals contract out their Audiology services to private organizations which then use the "non-profit" hospital facilities to sell hearing aids commercially. In some cases the hospital administration is not aware that the hospital facilities are being used for profit-making activities.

I feel that any commercial activity by a nonprofit, tax exempt, organization is unfair if it is not taxed like any other business.

Very truly yours

S. Markosian

S. Markosian

A Division of SOUND MEASUREMENTS, INC.

STATEMENT OF DISABLED AMERICAN VETERANS BEFORE THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ON DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

April 14, 1988

The Disabled American Veterans is a corporation chartered under an Act of Congress in 1932 and is qualified as an organization exempt from federal income tax under Section 501(a) of the Internal Revenue Code by virtue of its being an organization described in Section 501(c)(4) of the Internal Revenue Code.[1]

The most important activity of Disabled American Veterans is its national service program which involves the employment of several hundred national service officers who are, themselves, disabled veterans. These officers represent veterans before Veterans Administration boards with respect to obtaining the benefits to which such veterans are entitled by law. This service is performed free of charge to the veteran and the salary and expenses of the national service officers are paid by funds raised by Disabled American Veterans. Disabled American Veterans also carries out a limited scholarship program and a disaster relief program for which funds are raised.

Section 1601 of the Tax Reform Act of 1986 enacted Code section 513(h)(1)(B). This Code section provides that in the case of any organization exempt from taxation under Code section 501 and eligible to receive tax-deductible charitable contributions the term "unrelated trade or business" does not include exchanges or rentals of donor or member lists by such organization with another such tax-exempt organization.

The reason for the enactment of Code section 513(h)(1)(B) was to overturn, legislatively, the decision in Disabled American Veterans v. United States, 650 F.2d 1178 (Ct. Cl. 1981), to the extent that it held that revenue received by Disabled American Veterans from other exempt organizations for the use of its mailing lists constituted unrelated business taxable income, and did not constitute "royalties" for purposes of Code section 512(b)(2).

None of the options currently being considered by the Subcommittee on Oversight with respect to the unrelated business taxable income should affect directly Code section 513(h)(1)(B). One of the discussion options, however, involves what would be a substantial restriction of the Code section 512(b)(2) exclusion of royalty income from the unrelated business income tax. The proposed restriction of the exclusion of royalties would result in the application of the unrelated business income tax to (i) royalties measured by net or taxable income and also to (ii) royalties from the use of property where the organization (or a closely related organization) either (a) created such property or (b) performed substantial services or incurred substantial costs with respect to the development or marketing of such property. The present law rules for certain non-working property interests and the exception for products that are part of the organization's exempt function would be retained.[2]

Historically, there has existed some confusion as to whether income received by an exempt organization with respect to the use of names on its donor or member mailing lists constitutes royalty income. See, e.g. Disabled American Veterans v. United States, supra. In light of this, we respectfully request that any final proposals issued by the subcommittee clarify that it is not the subcommittee's intention, in modifying the exclusion for royalty income, to limit or restrict, indirectly or otherwise, the exclusion from the definition of unrelated trade or business codified at Code section 513(h)(1)(B).

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[1] The purposes of the Disabled American Veterans, as set forth in its bylaws, are: to uphold and maintain the Constitution and the laws of the United States; to realize the true American ideals and aims for which those eligible to membership fought; to advance the interests and work for the betterment of the wounded, gassed, injured, and disabled veterans; to cooperate with the United States Veterans Administration and all other public and private agencies devoted to the cause of improving and advancing the condition, health and interests of all wounded, gassed, injured and disabled veterans; to serve our comrades, our communities and our country; and to encourage in all people that spirit of understanding which will guard against future wars.

[2] See Press Release #16, Subcommittee on Oversight, Committee on Ways and Means, March 31, 1988, p.3.

We understand that a principal impetus for this review of the unrelated business taxable income rules is the concern that some exempt organizations may be competing unfairly with the for-profit sector. The use of names on donor or member lists by a tax exempt organization with another organization, irrespective of whether the recipient organization is a tax-exempt entity itself, is not an activity that allows a tax-exempt organization to use its tax-exempt status unfairly visa-a-vis the for-profit sector. Indeed, no competition--unfair or otherwise--exists as a result of such activities. Moreover, by engaging in such activities, a tax-exempt organization that is dependent on contributions and dues payments is able to protect its list from the threat of becoming obsolete as a fund-raising instrument. Thus, such activities are vital to the continuation and development of the tax-exempt activities of such organizations.

For these reasons, we also request that the subcommittee affirmatively provides that any proposed restrictions in the present law exception for royalty income are not intended to make revenue from the use of donor or member mailing lists subject to taxation. Alternatively, the subcommittee could recommend that property rights with respect to the use of names on such mailing lists be identified as qualifying for the exception for products that are part of the organization's exempt function.

This statement has been respectfully submitted by Mr. Charles E. Joeckel, Jr., in my capacity as Executive Director, Washington Headquarters of Disabled American Veterans.

Edison
Community College

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

Dear Mr. Leonard:

This letter is in response to the call for public comment concerning "options relating to the unrelated business income tax." I am the curator of the gallery here at Edison Community College. Following are my comments as a museum professional. They do not represent an official position by the trustees or administration of the college or the ECC Endowment Corporation. The college's galleries serve students and the general public with exhibitions and other educational activities. We have a membership program through the college's non-profit foundation and conduct some revenue-generating programs through it, as well.

The House Ways and Means Subcommittee is presently considering several changes in the tax laws concerning non-profit organizations' revenue-producing activities which could have a serious impact on museums' educational services for the community. For instance, we and many other museums offer educational trips for our gallery members, students, and the general public to visit other galleries and museums. Usually, these trips are to locations which would be inconvenient or impossible for our students and community members to visit individually. (This is particularly true for our older patrons.) In most instances, we could not offer the trip at a reasonable price if we limited the trip to students or gallery members. No travel agents in Southwest Florida offer similar travel opportunities; and we have never had a complaint from any travel agency in the three years we have offered this program.

We also sell posters, postcards and other memorabilia on occasion in connection with gallery exhibitions. While most of these sales would meet the "directly related" test as proposed, justifying each sales activity to I.R.S. could be very time consuming and constitute a major problem for small scale organizations like ours.

It is probable that some small business will be quite vocal in support of the proposed changes. However, I would ask that the committee carefully consider whether the travel and sales activities of museums really compete with small business in any substantial way. With increased competition for grants and other governmental sources of funding for museums, the income generated in-house is very important.

Thank you for your attention to my comments.

Sincerely,

Jay Williams
Jay Williams, Curator
Gallery of Fine Art

/kc

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EDUCATIONAL COMMISSION for FOREIGN MEDICAL GRADUATES

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April 14, 1988

The Honorable J. J. Pickle, Chairman
Oversight Subcommittee
Ways and Means Committee
House of Representatives
c/o Robert J. Leonard, Esq.
Chief Counsel
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

We have learned that the Oversight Subcommittee is considering several options for revision of the unrelated trade or business income tax and that one of the options being considered may apply the unrelated trade or business income tax to "testing income."

I am writing on behalf of the Educational Commission for Foreign Medical Graduates (ECFMG) which is responsible for testing knowledge in the basic and clinical medical sciences and measuring the level of competence in the English language of graduates of foreign medical schools who wish to enter the United States. Most of these physicians plan to enter residencies or fellowships in graduate medical education programs in hospitals or other institutions in this country. ECFMG derives virtually all of its income from fees for these testing services and has been determined to be exempt from federal income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code.

We expect that "testing income," as noted above, would not include the type of testing that is performed by the Educational Commission for Foreign Medical Graduates.

Let me know if there are questions.

Sincerely,

Ray L. Casterline, M.D.
Vice President

ELDERHOSTEL is an independent non-profit organization which seeks to serve the educational needs of older adults. Through a network of over 1000 colleges, universities, and other educational institutions, ELDERHOSTEL offers low-cost, residential academic programs for older adults in all 50 states, the District of Columbia, Canada and 39 other foreign countries. ELDERHOSTEL currently serves more than 238,000 "hostelers" and has grown at a rapid rate since the program's first offering some 13 years ago, when 200 people participated in 5 ELDERHOSTEL programs at New Hampshire colleges and universities.

ELDERHOSTEL is an educational program for older adults who want to continue to expand their horizons and develop new interests and enthusiasm. It is for older citizens on the move, not just in terms of travel, but in terms of intellectual activity as well. ELDERHOSTEL's commitment is to the belief that retirement does not represent an end to significant activity for older adults, but a new beginning filled with opportunities and challenges. ELDERHOSTEL welcomes individuals 60 years of age or older, together with their spouses or companions who are at least 50 years old.

ELDERHOSTEL has it origins in the youth hostels of Europe and the folk schools of Scandinavia. ELDERHOSTEL founder, Marty Knowlton, a well-known social activist and educator, was impressed by the way in which a network of modest accomodations encouraged and nurtured an adventuresome hosteling spirit in European youth. Using that concept, Knowlton launched a new movement in American adult eduation, offering the first ELDERHOSTEL programs in 1975. Five years later, Change Magazine, a noted educational publication, observed that the "momentum of ELDERHOSTEL after half a decade, is irreversible, its impact is ultimately immeasureable, as all humanistic advance is immeasureable. But it is real all the same and a cause for celebration."

In the U.S. and Canada, ELDERHOSTEL's short-term, residential academic programs bring a small group (35 - 45) of older citizens together for a week on the campus of a college, university or other educational institution which is part of the ELDERHOSTEL network. The participants are housed in a residence hall chosen to be the hostel and take their meals in the dining room with other students. Participating institutions design their own individual programs in accord with ELDERHOSTEL guidelines, offering 3 liberal arts courses (each 1-1/4 to 1-1/2 hours long) specifically designed for the participants on a non-credit basis, with no homework or testing. Courses are taught by regular faculty, enabling the institutions to build on their unique strengths and resources in their selection. A wide variety of extracurricular activities -- both on and off campus -- are made available to the hostelers.

To fulfill ELDERHOSTEL's mission to provide a network of residential, educational opportunities for older adults, it has worked ceaselessly to make access to its programs as easy as possible. In fact, accessibility is a key concept of critical importance to ELDERHOSTEL. Prior to the founding of ELDERHOSTEL in 1975, the educational needs of older adults were not thought to be an area of significant promise and potential -- mostly based on low participation rates in educational programs by the older adult student. The subsequent success of ELDERHOSTEL and considerable current research suggests that the traditional ways of registering for educational programs -- standing in lines on campus, filling out endless forms and suffering possible disappointments for your efforts -- are not appropriate for the older adult population. Older adults want and deserve a simple streamlined way of registering for courses.

ELDERHOSTEL achieves this end by publishing 6 seasonal catalogs per year. The catalogs describe each of the participating institutions and the Elderhostel programs and the courses which are available. The catalogs are mailed free of charge to any older adult who requests them. Approximately 2,500 older adults write to ELDERHOSTEL every week to request ELDERHOSTEL catalogs and newsletters. Each catalog contains registrations forms and potential participants can review program options, using the mail-in registration forms or telephoning the ELDERHOSTEL office to register for any program or series of programs in the United States, Canada, or international program through the ELDERHOSTEL centralized registration facility. In short, ELDERHOSTEL's centralized comprehensive catalog and centralized registration capabilities give older adults access to an international network of exciting educational opportunities at the comfort and convenience of their own homes.

ELDERHOSTEL colleges and universities range from the University of Texas at Austin to North Dakota State College and from the University of Minnesota in Minneapolis to Rhodes College in Tennessee. Their course offering are as varied as their geographic location. Whether it is Cicero or computers, politics or poetry, Shakespeare or Sophocles, they are all part of the 7,500 or more course offerings available through ELDERHOSTEL for active, inquisitive older adults. We have enrolled hostelers who have Ph.Ds and others who have never graduated from high school. The thousands of older students who participate in ELDERHOSTEL live in every state and travel extensively to coleges and universities. In the US and Canada, hostelers are responsible for making their own travel arrangements to and from the colleges and universities which are part of the ELDERHOSTEL network.

The cost of ELDERHOSTEL is intentionally modest. The charge for programs in the US this summer is approximately $225, except in Alaska and Hawaii where the charges are somewhat higher. This charge in an all-inclusive fee, which in a typical ELDERHOSTEL program on a college or university campus includes: registration costs, 6 nights' accomodations, all meals from Sunday supper through Saturday breakfast, 5 days of classes, and a variety of extracurricular activities.

ELDERHOSTEL recognizes that its fees, which are kept as low as possible, may still be beyond the means of many older adults. ELDERHOSTEL, therefore, makes available financial assistance in the form of "hostelships" to such individuals. This year more than $400,000 of hostelship assistance will be provided (to this end, ELDERHOSTEL works closely with major national and non-profit organizations who serve older adults: AARP, the National Council on the Aging, the National Urban League, etc.)

As part of its educational mission to serve older adults, ELDERHOSTEL offers international programs which are much like its domestic ones, except that the programs are usually 3 weeks in duration, one week at each of 3 different universities or colleges. Like the ELDERHOSTEL students who attend programs in the US, ELDERHOSTELers who participate in international programs attend classes and lectures, live in university and college dorms and eat in university cafeterias and dining halls. Like ELDERHOSTEL in the US, the courses are taught by the regular faculty of the participating institutions. The educational purpose and focus of ELDERHOSTEL's domestic and international programs are paramount.

As part of its international programs, ELDERHOSTEL makes possible appropriate travel arrangements for hostelers in order to insure the health, welfare, and safety of its older students, as well as to promote programmatic integrity and continuity. To do this end, ELDERHOSTEL engages the service of for-profit tour operators and travel agents. Such organizations arrange for ELDERHOSTELers to travel to and from their home communities to the country or countries and educational institutions hosting ELDERHOSTEL programs in which they have enrolled. They also make arrangements for all travel within the country in which the programs take place.

Though ELDERHOSTEL courses and programs are not for credit and there are no exams or grades, courses are of college-level-quality, as the cirriculum of the ELDERHOSTEL movement recognizes the needs in older adults for lifelong learning. The educational programs conducted by ELDERHOSTEL both within and without the US directly fulfill the organization's mission and purpose (i.e., to serve the educational needs of older adults). ELDERHOSTEL programs are in fact, the only acticities conducted by the organization and are the sole reason for its exsistance.

Since its beginning, ELDERHOSTEL has had one major goal: 1) to expand the program as rapidly as possible, consistent with ELDERHOSTEL standards of quality, in order to serve the maximum number of older adults possible. ELDERHOSTEL receives no federal support whatsoever and, 13 years after its inception, has grown from an organization which received 100% of its funding from external sources to one which is entirely self-sufficient and financially independent. In a relatively short time, ELDERHOSTEL has grown into a movement of major national and international significance serving the educational needs of older adults (see attached articles. 1) The Christian Scientist Monitor, Friday, August 21, 1988 2) TIME Magazine, July 23, 1984 3) The Los Angeles Times, October 19, 1986).

ELDERHOSTEL is a financed primarily by an administrative allocation from each hosteler's tuition, which is approximately 5% of total tuition. In spite of the ravages of inflation, the administrative fee has remained the same for four years.

ELDERHOSTEL is deeply concerned that Congress, in its appropriate efforts to correct abuses by non-profit orgranizations engaged in commercial activities unrelated to their essential mission and purpose will mistakenly apply the unrelated business income tax to ELDERHOSTEL's international programs. In spite of the fact that such programs fulfill its direct mission and purpose, The Subcommittee's "Discussion Option" I D suggests an exemption from such tax for travel services provided only for colleges and universities whose students are participating in a degree program cirriculum. It would seem to us, however, that ELDERHOSTEL is not engaging in any competition with tour operators or travel agencies, but is in fact going to some length to use the expertise and services of commercial organizations to arrange for the travel component of the older adults whom we are dedicated to serving.

ELDERHOSTEL as a program has received universal recognition from elected representatives, both at the federal and state level for its efforts to enrich the lives of this nation's older adults. We would hope that Congress would not throw the baby from the water by limiting the exemption of the imposition of the unrelated business income tax to travel services related to degree granting cirriculum. To do so in the case of ELDERHOSTEL would strike at the very heart of our mission and purpose of providing educational program through colleges and universities for older adults.

Submitted By: Michael Zoob
Michael Zoob, Vice President

(Additional attachments submitted are being retained in committee files)

FRIDAY, AUGUST 21, 1987

Elderhostel offers older-adult courses at worldwide sites

By Richard Bachus
Special to The Christian Science Monitor

Concord, Mass.

It's not a typical setting for a classroom. But then the 47 students listening to a lecture on the American Revolution here at the Minute Man National Historical Park aren't typical, either.

They are senior citizens – a small fraction of the growing number of older adults discovering an inexpensive, enjoyable way to learn. They've come from all over the country to participate in Elderhostel – an international network of education programs for senior citizens that has grown from 275 participants in 1975 to 142,000 this year.

Elderhostel expands on the idea of the popular European youth hostels. Adults 60 years old and older can study subjects from archaeology to zoology on campuses and at education centers around the world – sharing dormitory rooms, libraries, and recreational facilities.

The low cost (between $215 and $225 for programs in the United States) and one-week course duration allow many Elderhostelers to travel regularly. Jack and Frances Karlan from New Jersey, for example, have attended 15 Elderhostel courses in the last several years, on campuses from New Hampshire to North Carolina. The number of institutions that host Elderhostel programs has grown from the original five New Hampshire schools to 1,100 today.

For a higher cost (and longer stay), seniors can attend an overseas program such as the Great Barrier Reef course offered at the University of Queensland on Lady Elliott Island in Australia, or a course on great painters of the 20th century held at the University of Madrid.

Elderhostel was founded in 1975 by Martin P. Knowlton, an activist and educator with a commitment "to the belief that retirement does not represent an end to significant activity for older adults but a new beginning . . . ."

Mike Zoob, vice-president of Elderhostel, says that though it began as a summer program, "the fastest-growing aspect of the program is its expansion into the academic year."

"These people are motivated by an interest in learning new ideas and getting a different outlook," said one New York Elderhosteler attending the course at the Minute Man Park. It's not unusual to find students in their late 70s and 80s, she says. Her particular group has come to Concord to take part in a course sponsored by the Center for American Studies called, "The Constitution Through Our History."

"I got a different perspective on how the Constitution developed," said Mr. Karlan after the course was completed. He never realized that American Indian philosophy might have had an influence on the formation of the Constitution. "There was a lot of good stuff there," he said.

Course catalogs are avialable from Elderhostel, 80 Boylston St., Suite 400, Boston, MA 02116.

Education

Elderhostelers on a bird watch at Virginia's Washington and Lee University

They Call the Teacher "Sonny"

Students over 60 flock to academe in the Elderhostel program

On U.S. campuses from Maui to Massachusetts, more than 45,000 seniors are going back to school this summer. They are studying everything from quasars to Hawaiian quiltmaking, Plato to paleobiology. Some are traveling to archaeological sites in Israel; others are bird watching in Virginia. They may wake up stiff after sleeping on cots and feel even less comfortable about communal bathrooms. Like other college students, they undoubtedly grouse about cafeteria food. But there is one big difference between these seniors and the ones who donned caps and gowns a month or so ago: their average age is 68.

These new-old students are participants in Elderhostel, a program that combines the low cost of youth-hostel living with the challenge of college courses. The only admission requirement is that students be at least 60 years old (or accompanied by a senior citizen). Founded by former Teacher Martin Knowlton, 64, Elderhostel picks up where most adult-education classes leave off. After spending four years walking through Europe and observing adult-education programs, Knowlton came back to the U.S. determined to eliminate "a lot of the negatives associated with retirement." He believes that "when you're older you learn every bit as well as you ever learned in your life and probably better." Knowlton started the first Elderhostel in 1975 at New England College in Henniker, N.H. Since then, the program has grown mostly by word of mouth. Some foundations and corporations contributed to its development, but the Boston-based enterprise is nearly self-supporting now, with 80,000 students at 750 educational institutions in the U.S. and abroad paying $24 million this year. Part of its success comes from its modest price: one week of courses, room and board costs under $200 in the continental U.S.

The other key to Elderhostel's success is that it is stimulating without being too strenuous. Faculty members at host colleges and universities create their own curriculums, and academic difficulty varies accordingly. Required homework is taboo, but elders are often given the regular college syllabus for reading on their own. At Whittier College in California last month, Elderhostelers began their day at 8 a.m. with breakfast followed by a 9 o'clock class called American Politics on Film. A 10:30 class offered hands-on training with Apple computers. Afternoons, everyone hopped into the shallow end of the college pool for a course called Aquasize, or aquatic exercise. Dinner was at 6 p.m., followed by a 7 p.m. screening of the movie to be discussed at the next morning's politics class.

Elderhostelers are generally seeking adventure, but many arrive with specific goals. Nearly 60% have college degrees, and 30% have been schoolteachers. Edwin Slocum, 91, a former accountant from Van Nuys, Calif., took a computer course at Whittier. His reason: "When my grandchildren begin talking about computers they lose me fast." Estella Bagnell, 85, a former bookkeeper now living in Tampa, took a course in writing family history at Rollins College in Florida because she wants to put her research on the genealogy of the Bagnell family into narrative form for her eleven grandchildren and six great-grandchildren.

Elderhostel provides a camaraderie that many older people find missing from their lives. Says Mary Fox, 68, a former teacher: "The courses are terrific, but the people themselves are the best." At the end of Whittier College's program, Louise O'Farrell, 63, a retired bookkeeper, and Margaret Berlier, 72, a former teacher, made plans to meet again in London at an August Elderhostel. O'Farrell has attended 20 Elderhostel courses so far, ranging from entomology and botany at Eastern Kentucky University to Victorian art at the University of London. Says she: "Getting the Elderhostel catalogue is like getting a wish book for Christmas."

Teachers find that Elderhostel students can be refreshingly different from seniors of traditional college age. Says Arnold Wettstein, a professor of religion at Rollins College: "These people know who they are and are quite willing to look at the professor and say, 'Now, Sonny, you don't have this straight.' " In one communications class at the University of Northern Colorado, the teacher chose the bombing of Pearl Harbor as an example of the result of poor communications. She was challenged by one of her students, who turned out to be a retired Air Force general. Besides their experience and sense of history, elders provide another plus for professors. Observes George C. Higgins Jr., who teaches an Elderhostel course in psychopathology at Trinity College in Connecticut: "They are not trying to get a high score so they can get into law school or compete for a job. The thing that's marvelous is that they are all interested in ideas." —*By Ellie McGrath. Reported by Cheryl Crooks/Los Angeles and Sara White/Boston*

A class in German culture at Regis College in Massachusetts

Adventure, camaraderie and the challenge of college courses.

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Los Angeles Times Sunday, October 19, 1986

Lively's the Theme at Elderhostel

By RUTH HAMEL

NOGALES, Ariz.—It certainly didn't have the ring of a faraway place or the sound of a glamorous hideaway, but Nogales was the place our friends chose for our introduction to the Elderhostel program.

So off we went. We knew it was the kind of vacation we liked; there would be interesting people, new things to learn and a different part of the country to explore. Now the week is over and our big decision is, "Which Elderhostel shall we enroll in next?"

There were 43 hostelers from 14 states of the Union and Canada in our class. They were writers, physicians, musicians, engineers, teachers and non-professional people. When a "student" corrected one of our teachers, she laughed and said, "Talking to an Elderhostel group is like talking to the Encyclopedia Britannica."

Our weeklong course, under the supervision of the University of Arizona, included Arizona history, conversational Spanish and Mexican and Indian art. The cost: $205. The classes were lively and stimulating and the teachers had an infectious enthusiasm that charmed us all.

Bubbled and Joked

Our history teacher was Susan Clarke Spater, a graduate of Smith College, with a master's degree from the University of Michigan. Spater bubbled, joked and taught Arizona history with an emphasis on Santa Cruz County, "Arizona's best-kept secret."

She poked fun at her own fervor and said, "People accuse me of thinking Nogales is the center of the universe." By the end of the week I thought she might be right.

Arizona history, facts and dates rolled off her tongue as if they were on a computer printout but with a lot more sparkle. Her facts had to sparkle to keep pace with her red stockings, dangling earrings and love for her topic.

From her we learned that Jacob Isacton, a Russian immigrant, started a trading post in Nogales Pass in 1800 when the railroad line was being surveyed. From that beginning Nogales grew to the "gateway to the north." Today as many as 600 semi-trucks, loaded with produce, cross the border at the Nogales station and head for Canada and the East Coast. When the border is closed, Mexican produce rots in the trucks.

Residents think of Nogales, Ariz., and Sonora, Mexico, as one city. They concede that Nogales is more like Mexico than it is like the United States and enjoy its lazy charm. One returning native son said, "I knew I was in Nogales when I saw the American flag flying upside down."

For future trivia games we know that a Nogal is a walnut tree (there aren't many left in Nogales) and that the Huichol Indians, seen begging in the streets of Sonora, are nomadic and may ride free on any airline, bus or train in Mexico.

Our Spanish teacher was Teresa Leal, a small, dark and fiery woman with a commitment to Mexico's poor, the plight of the Indians and women's rights.

Leal was born in Syracuse, N.Y., moved to Mexico when she married at the age of 18, and learned to speak Spanish after that. She teaches Spanish above the border and English and French in Sonora. She writes a daily column for La Voz del Norte, a Mexican newspaper and, in her spare time, cares for her eight children, of whom the youngest is 4.

When we asked her how she found time for Elderhostel she replied, "You are therapy for me—so light—so nice."

Her comments about Mexican politics were eye-openers and some of us showed more interest in her politics than in our conversational Spanish. As quickly as we would lead her away from the class outline, someone else would take her back to verb conjugation.

The third class of each day was Mexican and Indian art taught by Carinne Holm Melton, who was born and raised in Guatemala. Melton illustrated her lectures with slides of modern and primitive art, and each day wore a costume brighter and more colorful than the slides she showed.

In addition to our classes we took field trips to Nogales and Sonora and wandered through the shops with our shopper's guide. We visited the Pimeria Alta Museum for a margarita party and a review of local history. We saw the chile factory, stopped at Mariposa Ranch for a short lecture on ranching, went to the Neighborhood Center for a concert by the Quintessence Woodwind Ensemble and took a walking tour of Nogales.

We traveled by bus to the Tumacacori Mission established by Father Kino in 1751. It was abandoned after Mexico won independence from Spain and, in 1849, a traveler named Hays wrote of Tumacacori:

"The fruit has fallen and none to gather it. Corrals still standing—not a living thing seen. It has a melancholy appearance."

In 1908 the mission became a National Monument, and today's traveler can see living demonstrations of what life was like during mission days. There are also lectures and self-guided walks of the gardens and buildings.

Our "graduation dinner" was Friday night and one other first-timer said, "I feel as if I've made a whole new family and now I may never see any of you again."

But the main topic of the last evening was, "Where are you going next?" And the answer: "Well, I've applied for Fort Robinson, Neb.," or "We want to go to England but our second choice is Italy," or "We're signed up for Mexico to study Spanish for two weeks."

Elderhostel is for any one over 60 (or for any couple where one partner is over 60), and you're welcome whether you're married, single, divorced, widowed or separated.

More than 1,400 study programs are listed in the Elderhostel catalogue, under the direction of 700 colleges and universities in the United States, Canada and Israel. There are also 13 programs in France, Germany, India, Mexico, Spain and Switzerland in cooperation with the Experiment in International Living.

To receive a catalogue, write to Elderhostel, 80 Boylston St., Suite 400, Boston, Mass. 02116. Local libraries also receive a special edition.

If my teen-age years were my salad days, Elderhostel helps to make retirement the dessert course.

Hamel is a Newport Beach free-lance writer.

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Los Angeles Times

ELDERHOSTEL

For Learning
And Adventure

When's the last time you treated yourself to a new adventure . . . an adventure where you could challenge your mind, explore new places and meet warm, friendly, delightful people?

Now you can do all that and more—with ELDERHOSTEL!

"ELDERHOSTEL is alive and exciting. People who are content to sit by the TV or stay put will not be interested. For those, however, who see the world yet as a place to experience adventure, to be confronted by a daily challenge, to listen to new points of view and to savor the opportunity to be confronted with an opinion at odds with their own, it will be a welcome experience."

Katy Perry
Gardener, ME

"My words are inadequate to express the super opportunity ELDERHOSTEL has given us, will give us and offers to all. The experience is so joyful, encouraging and fascinating, it invites comparison to eating popcorn or peanuts: one can't stop, but wants more and more!"

Bill Hafstrom
Denver, CO

Place
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ELDERHOSTEL
80 Boylston Street, Suite 400
Boston, MA 02116

ELDERHOSTEL

Have you ever wanted to . . . learn how to use a computer? . . . delve into the works of Shakespeare? . . . study the ecology of the Ontario wilderness? . . . analyze the American economy? . . . discuss Dostoyevsky over lunch with your literature professor? . . . get tips on improving your watercolor technique from a talented classmate? . . . meet active, intellectually curious people who are adventuresome like you?

. . . ELDERHOSTEL offers a unique opportunity to do all these things and much more!

What is ELDERHOSTEL?

Every year, thousands of people in their 60s and older participate in ELDERHOSTEL programs at over 850 colleges, universities and other educational institutions in the U.S., Canada and more than 30 countries overseas—including the Scandinavian countries, Great Britain, Ireland, Italy, Israel, Greece, Egypt, Australia and New Zealand. With ELDERHOSTEL, you can live on a college campus for a week or more and take up to 3 non-credit courses on a wide variety of liberal arts-and-sciences subjects, taught by the host institution's faculty. The courses are challenging and thought-provoking, yet require no prior knowledge or formal training in the subject.

While participating in an ELDERHOSTEL program, you will stay in a dormitory, eat in the campus dining facilities and have access to the educational, cultural and recreational resources your host institution has to offer. You'll be sharing your daily life with 20-40 ELDERHOSTEL classmates who, like you, are interesting, lively people from many different backgrounds.

Cost

The cost of an ELDERHOSTEL program is low—just a little over two hundred dollars for a one-week program in the United States and Canada. This fee covers tuition, room, board, use of campus facilities and a variety of extracurricular activities as well. A number of scholarships—called "hostelships"—are available to people who require financial assistance in order to attend a program. Information about hostelships can be found in the ELDERHOSTEL catalog.

International Programs

For programs overseas, the cost is also surprisingly low. Typically, overseas programs are 3 weeks in length and involve campus stays at 3 different institutions. The courses offered usually explore some aspect of the host country's culture and history.

Air fare and all land travel for overseas programs are included in the cost, making an ELDERHOSTEL experience overseas enjoyable and trouble-free.

Who Can Participate?

ELDERHOSTEL programs are open to anyone who is age 60 or older, or the spouse or companion of an age 60+ participant, regardless of educational background. College professors delight in discovering that 60+ years of life experience creates wisdom and an eagerness to learn. Whether you completed your formal education with grammar school, high school or college, if you have an adventuresome spirit, ELDERHOSTEL is perfect for you!

ELDERHOSTEL is a great way to exchange ideas, sample college life and make new friends with active, interesting people with whom you can share the joys of a new experience. It's a unique opportunity to combine study with the adventure of exploring someplace new in a friendly and supportive academic environment. That's why our participants say, "Studying there is half the fun!"

For more information about ELDERHOSTEL, and for a copy of our free catalog, fill out the attached card and mail it to ELDERHOSTEL today . . .

. . . an adventure is waiting for you!

Send For Our Free Catalog

ELDERHOSTEL publishes 3 seasonal catalogs yearly, as well as 3 entertaining, informative newsletters. These publications are free. To receive them, simply fill out and mail the attached reply card to ELDERHOSTEL.

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ELDERHOSTEL

A current edition of the ELDERHOSTEL catalog is also available at your local public library. So while you're waiting for your own copy to arrive, why not get a head start on your hosteling plans by reading your library's ELDERHOSTEL catalog?

602

Essex
Institute

132 Essex Street Salem, MA 01970
(617) 744-3390

April 14, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Pickle:

As a non-profit regional museum on Boston's north shore, we ask for your careful consideration regarding any changes to the Unrelated Business Income Tax (UBIT).

To give you some background on our organization, the Essex Institute, established in 1841, was set up to collect, preserve, and interpret the history and culture of Essex County from the 17th century to the present day. Our Museum Neighborhood includes galleries, seven historic houses, gardens, a research library and a museum shop.

All profits from the museum shop go directly to the museum. In today's economic climate, museums and other non-profit organizations are expected to be more and more self-sufficient. Any loss in revenue generated by the museum shop would significantly impact the quality of the programs and services our institution provides, and result in budget cuts in all areas.

We strongly disagree with your proposed change to the wording of "substantially related" to "directly related" merchandise affected by the UBIT. This change would result in a financial burden that would extremely limit the museum's ability to offer a broad range of educational products. Many items that are not directly related to our collections still contribute significantly to the themes of our educational mission. For example, a book on Salem's maritime history not published by the Institute contains general background information on 18th century life which is extremely beneficial to the appreciation of our collections. Changing the classification of this and other items would restrict our ability to offer a full spectrum of merchandise relating to our history.

The cost of exclusive product development directly related to our collections is prohibitive. The ability to purchase merchandise that is significantly related in theme and style adds to the visitor's quality experience of our institution and directly affects our overall growth.

As members of both the American Association of Museums (AAM) and the Museum Store Association (MSA), we strongly urge you to reconsider your proposed change to the UBIT for non-profit organizations.

Sincerely,

Anne Farnam

Anne Farnam
President

ETL Testing Laboratories, Inc.

Industrial Park Cortland, New York 13045 Telephone 607-753-6711 TWX 510 252 0792

Earl J. Gmoser
Vice President

April 14, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. HOUSE OF REPRESENTATIVES
1102 Longworth House Office Bldg.
Washington, DC 20515

Re: Non-Profit Competition and Unrelated
Business Income Tax

Dear Mr. Leonard:

In the Subcommittee's News Release of March 31, 1988 there appeared several "discussion options" for UBIT reform, and one in particular is of major interest to us and relates to modifying rules applicable to organizations "testing for public safety."

This matter is of extreme importance, not only to ETL, but to numerous other tax-paying commercial laboratories doing "testing for public safety." The overly generous tax favored status of competing organizations puts us in a decidedly disadvantaged position when we and they compete for business in the same markets.

We assisted in assembling testimony for presentation by American Council of Independent Laboratories before Congressman J.J. Pickle's sub-committee, therefore, substantial detail on the abuses of the 501C-3 tax status by our competitors is well documented.

It is of some concern to us that this issue, which is so important to us, may get lost in the massive lobbying by non-profits on the overall subject of UBIT: The very fact that Congressman Pickle's sub-committee was established is a good indicator that the matter of UBIT abuses needs to be corrected, and your committee is the one to do it.

As a tax paying business we are hurt whenever any organization uses its tax-favored status to unfairly engage in commercial markets. We are seriously injured, in particular, when large tax-favored organizations use their 501C-3 "testing for public safety" status as an unfair financial barrier to our growth and the development of healthy competition.

We sincerely ask the sub-committee that its recommendation to the full committee on UBIT for organizations "testing for public safety" be that there are serious abuses and they need major corrections. Your sub-committee will help us all and treat the matter fairly by changing the rules on what constitutes UBI for tax favored organizations. Very simply put, make them pay taxes on business enterprises where they compete with the tax paying laboratories.

Sincerely,

Earl J Gmoser

EJG/tks

WILLIAM A. FARNSWORTH
LIBRARY AND ART MUSEUM

P.O. BOX 466
ROCKLAND, MAINE 04841

Telephone 207-596-6457

April 13, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1162 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

As the Director of a small regional art museum on the coast of Maine, I am deeply concerned by many of the recent "discussion options" that will seriously affect our ability to educate and serve the public.

Museums throughout the United States have long struggled to achieve fiscal stability through a balance of individual and corporate philanthropy, government grants (a diminishing resource) and earned income. Now, suddenly changes in the tax code are being proposed that could undercut, not only a vital source of revenue, but our educational mission. Applying UBIT to catalog sales for important scholarly exhibitions and study tours to other museums will have a chilling effect on attempts to develope new audiences, including minorities, the handicapped, and those who do not have ready access to museums.

Earned income is, of course, reinvested in other, less popular but essential functions such as scholarly research and conservation of collections.

I must say that the impact on my own small museum will be significent and very disruptive to our attempts at reducing deficits.

Museums are not businesses and should be encouraged to "earn their own way", to the extent we are in the "business" of serving the public's needs and best interests.

Sincerely,

Christopher B. Crosman
Director

CBC:cmh
Enc. 6 copies

FINDLAY HEARING AID CENTER
930 Plaza Street
Findlay, OH 45840
(419) 422-5242

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear House Ways and Means Oversight Subcommittee,

Thank you for proposing an excellent package of reform measures. This is a great help to us. We now urge you to please include all of these measures in the final report.

Of great concern to our small established business will be that Unrelated Business Income Tax apply to all hearing aid sales income of nonprofits. Although we would like to give to organizations such as United Way because of their contributions to our community, it is difficult to do so because of their financial support and funding to our competitors such as Betty Jane Memorial in Tiffin, Ohio. Time and time again as a nonprofit organization, they sell and fit hearing aids at prices comparable or exceeding our own. It is enough of a challenge to stay ahead of just the rise in our insurance costs from year to year, besides our many other expenses. Our office has been established in Northwest Ohio for over 35 years, and we would hope that your actions will support the success of our future.

We also want to encourage the Subcommittee to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

Sincerely,

Timothy A. Boehr
Co-owner

Jane M. Rosengarten
Co-owner

:bn

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LEWISTOWN, PA. 17044
PHONE 717 248 7700

420 MARKET STREET
LEWISBURG, PA. 17837
PHONE 717 524 9888

FOSS HEARING AID CENTER

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

I am writing to you relative to the options regarding reform of the (UBIT) unrelated Business Income tax system that applies to nonprofit organizations.

I want to thank the Subcommittee for proposing an excellent package of reform measures and I urge you to apply UBIT to all hearing aid sales Income of all nonprofit organizations.

Briefly, our nonprofit Lewistown Hospital has advertised extensively in newspapers, television and radio using donated funds and/or non-tax dollars. Would it be fair to assume that the equipment, aduiometers, etc. are purchased with Federal grants donated funds or non-tax dollars? They most likely charge a portion of labor, hearing aid testing, consultation fees to Insurance, Medicare or any third party papers. We also encourage the Subcommittee to repeal the existing "convenience" exemption for patients or recognise patients as in-patients only.

All of these advantages of the non-profit organization have an adverse effect on all independent small businesses and tends to be somewhat discriminatory and is certainly unfair competition.

Your consideration regarding the above matter will be greatly appreciated by all independent hearing aid fitters and dealers.

Thank you.

Sincerely,

Paul S. Foss

4 Seasons
VACATIONS, INC.

P.O. BOX 769 • 130 WEST CLARK STREET • ALBERT LEA, MINNESOTA 56007 • TELEPHONE 507-373-4705

APR 14 1988

April 12, 1988

APR 18 1988

Congressman Pickle
242 Cannon House Office Bldg
Washington, DC 20515-4310

Dear Congessman Pickle:

I want to commend you and the Ways an Means Subcommittee on Oversight for the time and effort you have devoted to the issue of unfair competition from tax-exempt organizations. As a for-profit tour company which has experienced first hand the serious problems associated with commercial competition from tax-exempt organizations, I can assure you that your efforts are most appreciated.

I am aware that the Subcommittee is considering a set of discussion options for addressing unfair competition. All of these options represent important steps in the right direction. One particularly significant option is to apply the Unrelated Business Income Tax (UBIT) to certain specified activities, including tour and travel service. These activities are commercial in nature. Therefore, if a tax-exempt organization engages in these, they should be treated as taxable activities. This is an extremely fair approach in that it provides an equitable and consistent method of addressing commercial activity, regardless of the type of organization carrying out that activity.

I encourage you to support the options now being considered by the Subcommittee. In doing so, you will be striking a blow for fairness in the marketplace and you will be providing a great service to countless struggling small businesses across America.

Sincerly,

James Brecke

James Brecke
4-Seasons Vacations, Inc.
Director Motorcoach Operations

JB:sh
cc: NTA

MINNESOTA: 800-642-9664
OUTSTATE: 800-328-4298

THE FRANK LLOYD WRIGHT
HOME AND STUDIO FOUNDATION
951 CHICAGO AVENUE OAK PARK ILLINOIS 60302 PHONE: 312 848-1976

April 14, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

I am writing with regard to the call for public comments on discussion options relating to the unrelated business income tax.

I am concerned that the effect of the proposed changes will constitute "throwing the baby out with the bath water" for many small to mid-sized museums. For many years the buzzword was that museums would succeed if they were run more like businesses. And many of us have attempted to do this, in good conscience, adhering to the established "substantially related" guidelines and also being sensitive to neighboring business concerns.

In our case, a non-profit historic house museum run by 400 volunteers and 14 staff members, we have struggled to creatively meet the challenge of reduced government funding and increased competition for corporate and private funding. As we are very near our maximum capacity for visitation -the house museum is small, and we can only accommodate a limited number of people --we anticipate that one of our areas for growth is through mail-order catalog sales (see attached). After inventory and overhead, proceeds from sales directly support the preservation of the first home and studio of one of America's most significant architects, and related educational programs open to the public.

The proposed changes in the regulations would significantly impact small museums by increasing operating costs and reducing revenues which can be allocated to further their educational mission. I urge you to weigh these considerations carefully when discussing the proposed changes in the unrelated business income tax.

Perhaps there are other ways to deal with abuses of current legislation - especially if done on a large scale - than by making blanket reforms which may dramatically affect smaller organizations struggling to preserve America's heritage or artistic legacy.

Sincerely yours,

Sandra K. Wilcoxon
Executive Director

SKW/vn
Enc:

The Frank Lloyd Wright
Home and Studio Foundation

Nonprofit Organization
U.S. Postage
PAID
Permit 416
Oak Park, IL

The Ginkgo Tree Bookshop

Item No.	Qty.	Description	Price Each	Total Amount	Shipping

Total

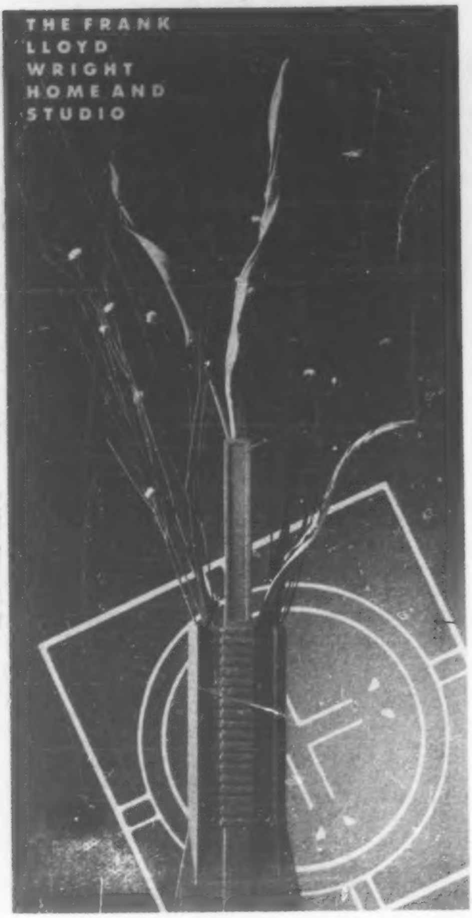
Method of Payment:

Shipping

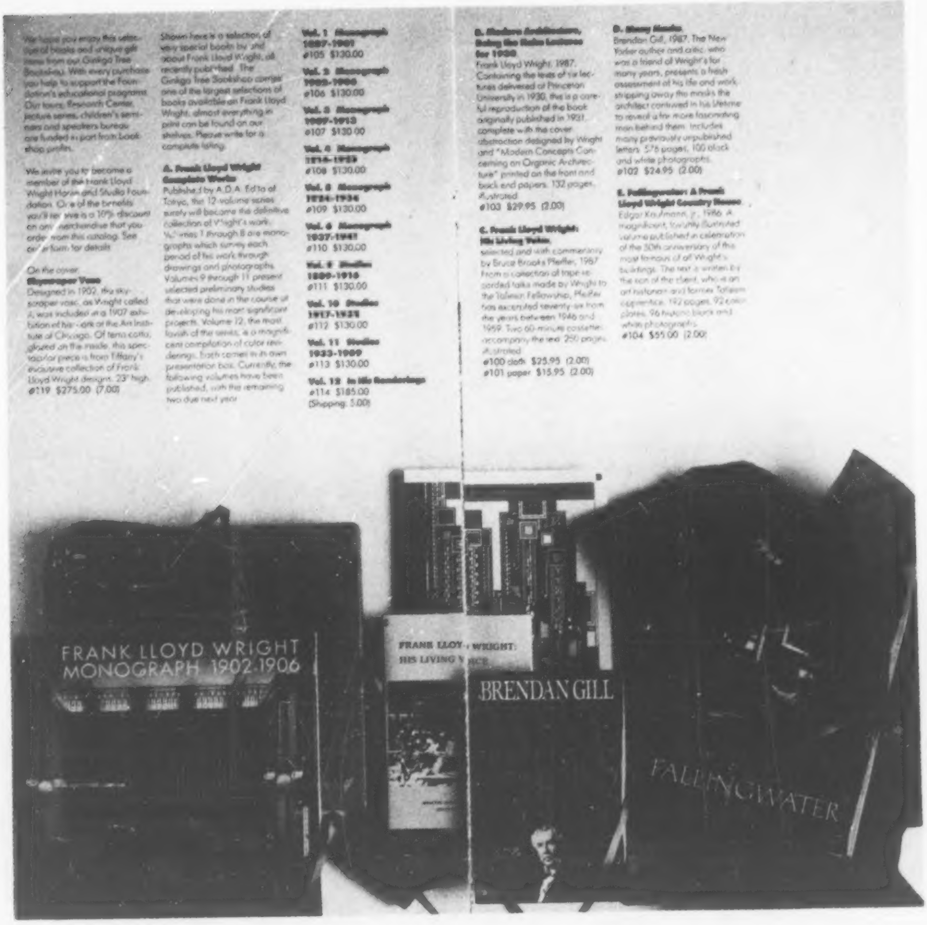
Total Due

Please note:

Shipping:



THE FRANK
LLOYD
WRIGHT
HOME AND
STUDIO



We hope you enjoy this selection of books and unique gift items from our Ginkgo Tree Bookshop. With every purchase you help to support the Foundation's educational programs. Our tours, Research Center, lecture series, children's seminars and speakers bureau are funded in part from bookshop profits.

We invite you to become a member of the Frank Lloyd Wright Home and Studio Foundation. One of the benefits you'll receive is a 10% discount on any merchandise that you order from this catalog. See order form for details.

On the cover:
Skyscraper Vase
Designed in 1902, the skyscraper vase, as Wright called it, was included in a 1907 exhibition of his work at the Art Institute of Chicago. Of terra cotta, glazed on the inside, this spectacular piece is from Tiffany's exclusive collection of Frank Lloyd Wright designs. 23" high.
#119 $275.00 (7.00)

Shown here is a selection of very special books by and about Frank Lloyd Wright, all recently published. The Ginkgo Tree Bookshop carries one of the largest selections of books available on Frank Lloyd Wright; almost everything in print can be found on our shelves. Please write for a complete listing.

A. Frank Lloyd Wright Complete Works
Published by A.D.A. Edita of Tokyo, the 12-volume series surely will become the definitive collection of Wright's work. Volumes 1 through 8 are monographs which survey each period of his work through drawings and photographs. Volumes 9 through 11 present selected preliminary studies that were done in the course of developing his most significant projects. Volume 12, the most lavish of the series, is a magnificent compilation of color renderings. Each comes in its own presentation box. Currently, the following volumes have been published, with the remaining two due next year.

Vol. 1 Monograph 1887-1901
#105 $130.00

Vol. 2 Monograph 1902-1906
#106 $130.00

Vol. 3 Monograph 1907-1913
#107 $130.00

Vol. 4 Monograph 1914-1923
#108 $130.00

Vol. 5 Monograph 1924-1936
#109 $130.00

Vol. 6 Monograph 1937-1941
#110 $130.00

Vol. 9 Studies 1889-1916
#111 $130.00

Vol. 10 Studies 1917-1932
#112 $130.00

Vol. 11 Studies 1933-1959
#113 $130.00

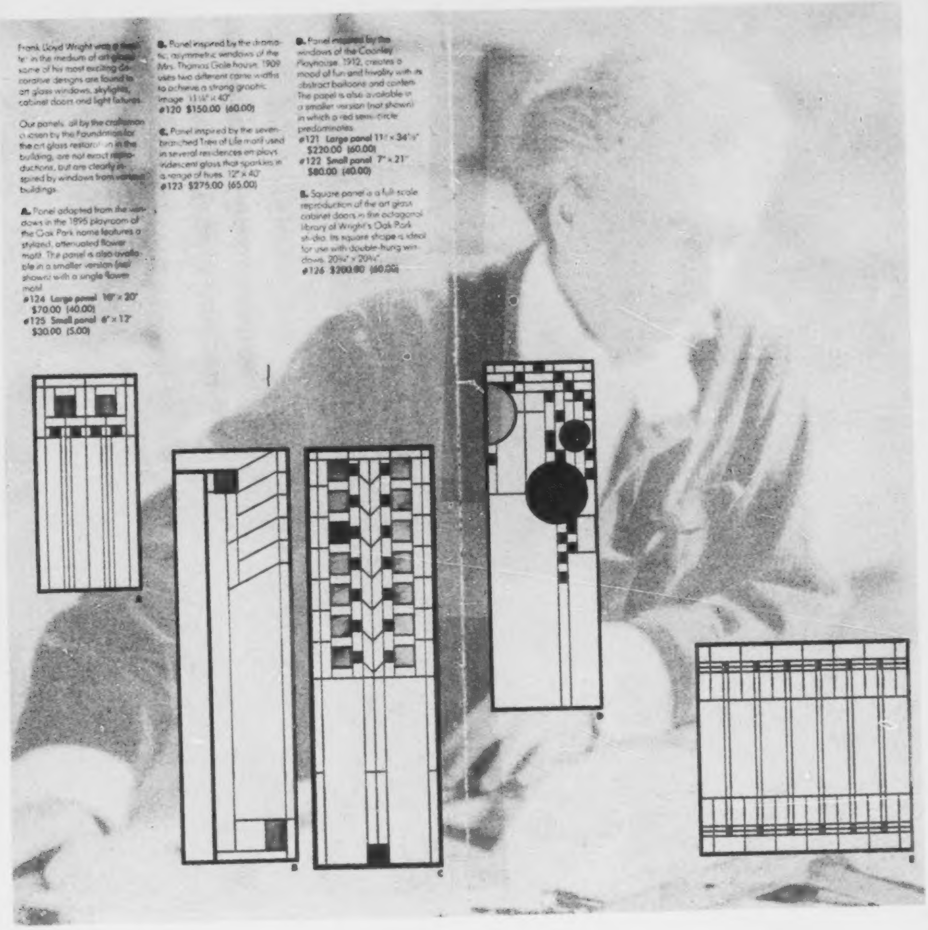
Vol. 12 In His Renderings
#114 $185.00
(Shipping: 5.00)

B. Modern Architecture, Being the Kahn Lectures for 1930
Frank Lloyd Wright, 1987. Containing the texts of six lectures delivered at Princeton University in 1930, this is a careful reproduction of the book originally published in 1931, complete with the cover abstraction designed by Wright and "Modern Concepts Concerning an Organic Architecture" printed on the front and back end papers. 132 pages, illustrated.
#103 $29.95 (2.00)

C. Frank Lloyd Wright: His Living Voice
selected and with commentary by Bruce Brooks Pfeiffer, 1987. From a collection of tape recorded talks made by Wright to the Taliesin Fellowship, Pfeiffer has excerpted seventy-six from the years between 1946 and 1959. Two 60-minute cassettes accompany the text. 250 pages, illustrated.
#100 cloth $25.95 (2.00)
#101 paper $15.95 (2.00)

D. Many Masks
Brendan Gill, 1987. The New Yorker author and critic, who was a friend of Wright's for many years, presents a fresh assessment of his life and work, stripping away the masks the architect contrived in his lifetime to reveal a far more fascinating man behind them. Includes many previously unpublished letters. 576 pages, 100 black and white photographs.
#102 $24.95 (2.00)

E. Fallingwater: A Frank Lloyd Wright Country House
Edgar Kaufmann, jr., 1986. A magnificent, lavishly illustrated volume published in celebration of the 50th anniversary of the most famous of all Wright's buildings. The text is written by the son of the client, who is an art historian and former Taliesin apprentice. 192 pages, 92 color plates, 96 historic black and white photographs.
#104 $55.00 (2.00)



Frank Lloyd Wright was a master in the medium of art glass; some of his most exciting decorative designs are found in art glass windows, skylights, cabinet doors and light fixtures.

Our panels, all by the craftsman chosen by the Foundation for the art glass restoration in the building, are not exact reproductions, but are clearly inspired by windows from various buildings.

A. Panel adapted from the windows in the 1895 playroom of the Oak Park home features a stylized, attenuated flower motif. The panel is also available in a smaller version (not shown) with a single flower motif.
#124 Large panel 10" × 20"
$70.00 (40.00)
#125 Small panel 6" × 12"
$30.00 (5.00)

B. Panel inspired by the dramatic, asymmetric windows of the Mrs. Thomas Gale house, 1909 uses two different came widths to achieve a strong graphic image. 11¼" × 40"
#120 $150.00 (60.00)

C. Panel inspired by the seven-branched Tree of Life motif used in several residences employs iridescent glass that sparkles in a range of hues. 12" × 40"
#123 $275.00 (65.00)

D. Panel inspired by the windows of the Coonley Playhouse, 1912, creates a mood of fun and frivolity with its abstract balloons and confetti. The panel is also available in a smaller version (not shown) in which a red semi-circle predominates.
#121 Large panel 11" × 34½"
$220.00 (60.00)
#122 Small panel 7" × 21"
$80.00 (40.00)

E. Square panel is a full-scale reproduction of the art glass cabinet doors in the octagonal library of Wright's Oak Park studio. Its square shape is ideal for use with double-hung windows. 20¾" × 20¾"
#126 $200.00 (60.00)

A. Garrick Theatre Panel
This panel is a reproduction of the decorative motif from the balcony of the Garrick Theatre in Chicago (originally called the Schiller Theatre) designed by Louis Sullivan in 1892. The more pronounced geometric elements in the decorative designs of this building perhaps may be due to the presence of Wright in the firm of Adler & Sullivan at that time. Of plaster reinforced with hemp, the panel comes ready to hang. For indoor use only. 35 pounds: 28½" × 26½" × 1½"
#133 $135.00 (50.00)

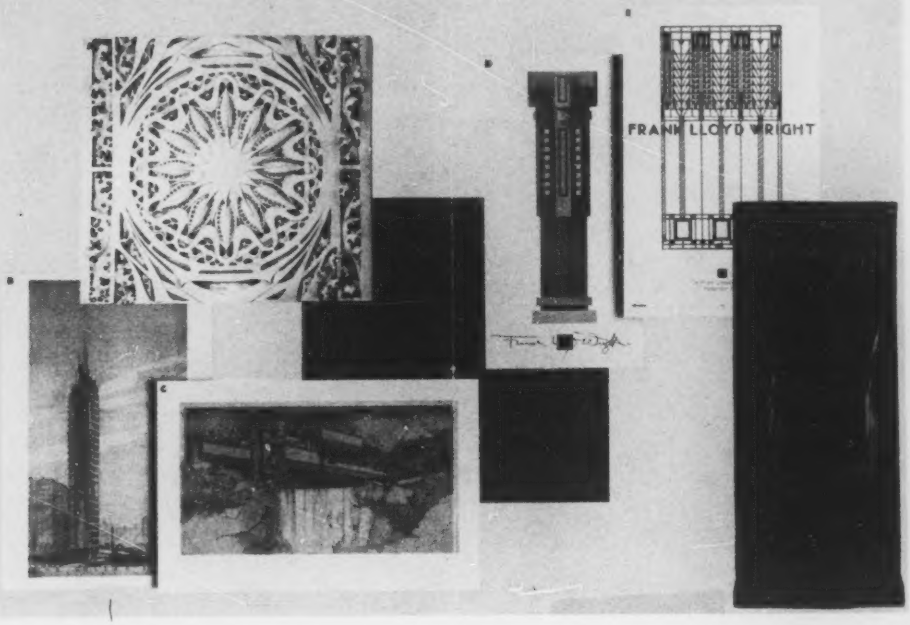
B. Golden Beacon Poster
Reproduction of a color pastel drawing done by Wright in 1956. Unfortunately, the magnificent 50-story apartment tower for Chicago was never built. 24" × 36".
#128 $18.00 (3.00)

C. Fallingwater Poster
Reproduction of a color pastel drawing done by Wright in 1936. 36" × 24"
#129 $18.00 (3.00)

D. Unity Temple Column Poster
This artist's rendering of the column capital with its stylized floral motif is one of our most popular posters. 18" × 28"
#130 $9.00 (3.00)

E. Art Glass Poster
Wright used the Tree of Life motif in windows for the Darwin Martin house, 1904. This poster was produced by the Milwaukee Art Museum in conjunction with a 1984 exhibition. 22" × 35".
#127 $15.00 (3.00)

F. Studio Panel
When Frank Lloyd Wright built his architectural studio in Oak Park in 1898, he designed three plaster columns at the entrance to be symbolic of the architect's profession. Like the originals, our reproductions are made of plaster with hemp added for strength, and painted bronze green. For indoor use only, the panels come ready for hanging. Available also in antique white. 30 pounds; 14½" × 34½" × 4½"
#131 green $185.00
#132 white $185.00
(Shipping: 50.00)



A. Imperial Hotel Dinnerware

#115 $180.00 (3.50)

B. Engagement Calendar

#142a $11.95 (2.00)

C. Crystal Candlesticks

#117 3½" candlesticks, pair $120.00 (4.50)
#118 6" candlesticks, pair $160.00 (4.50)

D. Scarf

#143a $25.00 (2.00)

E. Jewelry

#138a Lapel pin, 1" $38.00 (1.50)
#139a Post earrings, ½" $30.00 (1.50)
#140a Cuff links, ½" $42.00 (1.50)

June/July
27
28
4
5
6

A. Wall Calendar for 1988

[illegible]

#141 $16.95 (3.00)

B. Brass Ornaments

[illegible]

#144a pair $14.00 (1.00)

C. Bookmark

[illegible]

#146a pair $12.00 (1.00)

D. Robie House Model

[illegible]

#145 $6.50 (2.00)

E. Art Glass Cross Stitch Kits

[illegible]

#134a Left $15.00 (1.50)
#135a Center $15.00 (1.50)
#136a Right $15.00 (1.50)

F. Art Glass Cross Stitch Kit

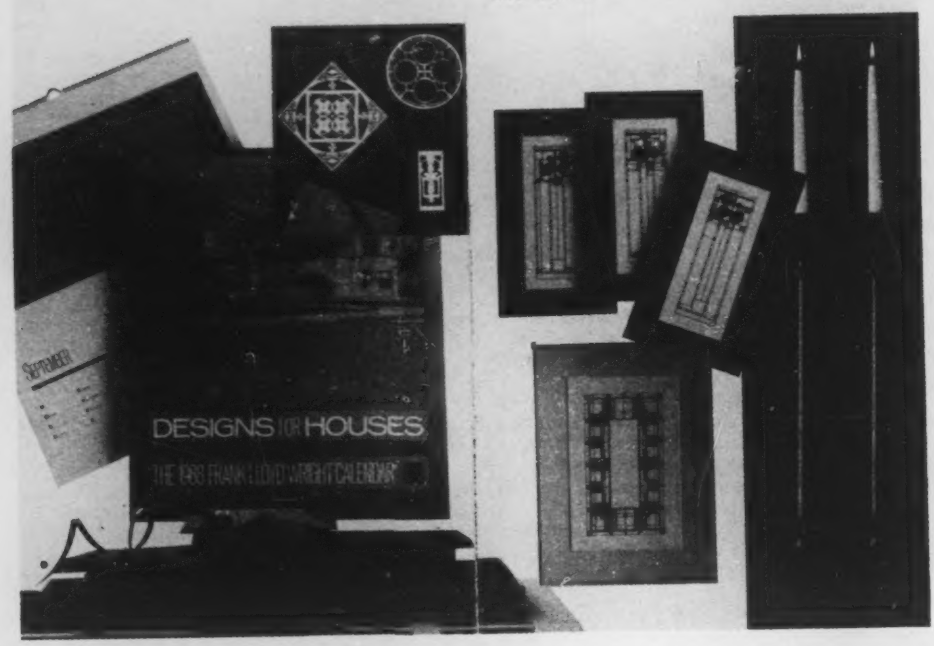
[illegible]

#137a $20.00 (1.50)

G. Oak Candlesticks

[illegible]

#116 pair $65.00 (2.50)


SEPTEMBER
DESIGNS FOR HOUSES
THE 1988 FRANK LLOYD WRIGHT CALENDAR

FREEPORT • HISTORICAL • SOCIETY

April 13, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

As a small local historical society, we are distressed by recent discussions to change current taxation prvisions for non-profit organizations. Attempts to narrow the tax exemptions we now enjoy would adversely limit our ability to provide quality education programs, preserve historical objects and documents, and research our local history.

Since the escalating costs of historical work and the intense competitiveness of fundraising have combined to place tremendous burdens on our tight budget, we need to have alternative sources to fund our organization which lessen the burden for our supporters. Actions by the Committee on Ways and Means to undermine our efforts would be devastating. The sources of revenue being reviewed are essential to meet our operating costs. We are not talking about fat in our budget, but programs critical to our mandate.

We ask the Committee on Ways and Means to seriously consider the effects the proposed changes would have on the nation's cultural life.

Sincerely,
Marilyn Gass
Marilyn Zoidis Gass
Executive Director

ESW

45 MAIN STREET, P.O. BOX 358
FREEPORT, MAINE 04032

The Friends of
Independence National Historical Park
313 Walnut St., Philadelphia, Pa. 19106
215-597-7919

April 13, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

RE: Options for Changing the Unrelated Business Income Tax

Dear Mr. Leonard:

In response to the call for public comment by the House Ways and Means Oversight Subcommittee, The Friends of Independence National Historical Park would like to submit the following remarks:

Background of the Friends

The Friends of Independence National Historical Park was formed in 1972 at the request of the Superintendent of Independence National Historical Park to aid in the preservation, development and interpretation of the Park. To this end, the Friends raises funds as necessary for administration, special programming, and accessions.

Friends obtain these funds through several means - through membership dues (both individual and corporate); through special events, such as openings of new exhibits and/or buildings in the park; through special tours of the greater Philadelphia area in a three week series of tours "Philadelphia Open House"; and through a summer refreshment stand, the Tea Garden. We offer publications to our members and the public from time to time; these are usually sold at cost plus a small markup.

In special circumstances, we have received funds from the National Endowment for the Humanities. The most recent occasion was the period 1985-87, when NEH funded in large part the major exhibit on the Bicentennial of the U.S. Constitution, "Miracle at Philadelphia."

In the 15 years of the Friends existence, we have raised nearly $3,000,000 for Independence Park. These monies have been used for exhibits, programs, and acquisitions for which no Federal funds are available.

In the 15 years of the Friends existence, we have amassed the total assets of $160,000. We are not, nor are we meant to be, a profit making organization.

We are recognized as a 501-c-3 organization, and accordingly, file a Form 990 each year.

The Problem

If we were asked to pay tax on our food sales, it would mean that our Tea Garden would be out of business. In 1987, the Tea Garden had net income of $8,549 on gross receipts of $42,207. This figure was possible only because the Manager of the Tea Garden functioned as a volunteer. If we are to pay taxes on profits produced by volunteers, we might as well fold up shop. We currently pay a concessioner's fee of 2% to the government, based on gross receipts. This is already an increase from the 3/4 of 1% we have paid previously. We are already taxed!

The profits earned by Philadelphia Open House are also produced by volunteers - in excess of 500 each year. The profits earned on this program are divided among the sixteen or so participating organizations. Here again, to put tax burdens on the funds earned would be disastrous for the organization.

We feel that the Friends has operated in a responsible and competent manner to achieve its goals. We feel that imposing UBIT on activities of the Friends would reduce the effectiveness of the organization, and limit its usefulness if not drive it out of existence.

The Request

Over 450,000 visitors toured Miracle at Philadelphia, and gained a deeper insight into the Constitution and the lives of the men who wrote it. And each year, over 4,000 visitors gain a deeper appreciation of our city and its variety through Philadelphia Open House. Our free summer tours bring a renewed sense of patriotism to over 3,000 tourists a summer. Our profits are used solely for programs and acquisitions.

Don't deprive Americans of the opportunity to appreciate fully their national heritage at Independence Park. Please allow us to function as we have done so successfully for 15 years - to the benefit of all those interested in the history of America. Please do not further tax our service to The National Park Service at Independence Park, and the 4 million visitors from around the world who come here each year.

Sincerely yours,

Susan O. Montgomery
Mrs. Edward A. Montgomery, Jr.
Chairman, Friends of INHP

FMC
FULLERTON MUSEUM CENTER

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Mr. Leonard,

We are writing today to express our concern regarding pending "discussion options" that will come before the House Ways and Means Subcommittee this month.

As a small community-based museum specializing in travelling exhibitions in science, history, and culture, much of our revenue comes from our Museum Store sales and other adjunct activities we sponsor that relate to our exhibitions. The proposed changes would have an adverse effect on our ability to maintain our levels of service to the community and to not request additional funding from our local municipality for exhibition expenses. It typically costs the Museum $4 per visitor to host an exhibition and our small admission donations do not adequately cover these expenses. Many of the items in our Museum Store and our trips, tours, and adjunct activities are not strictly educational, yet create an educational experience through other means such as socializing, tours, arts and crafts, lectures, etc. These activities currently fall under the "substantially related" test currently in force. Under the proposed changes, or a strict interpretation of such, this income may become subject to UBIT, thus changing our income producing capabilities.

A change in status for these income sources, exposing them to UBIT, would have a damaging effect on the cultural institutions of this country who are striving toward a common goal of providing for extracurricular educational; cultural; social; and community based programs and activities.

The cultural and art institutions of this nation are continually trying new and innovative ways to maintain our cultural heritage, insure its survival, and promote its future. Every effort is made, in our case, and I'm sure in the vast majority of cases, not to compete with businesses in the private sector in our effort to reach these goals.

On behalf of the Fullerton Museum Center Association, we urge you to maintain the current status of income producing activities sponsored by non-profit institutions in your upcoming discussions.

Sincerely,

Janet Buzan

Janet Buzan, President
Fullerton Museum Center Association

Joseph Felz, Director
Fullerton Museum Center

The Goodman Theatre Chicago Theatre Group, Inc.

Robert Falls, Artistic Director Roche Schulfer, Producing Director

April 8, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The implementation of the "discussion options" regarding UBIT currently under review by the House Ways and Means Subcommittee on Oversight would have serious consequences for the non-profit professional theatre in this country.

In almost every area, the "discussion options" will have a significant impact on professional theatre through taxation of gift shop sales, mail order and phone sales, advertising income, royalties, mailing list exchanges, and tour services.

The logic of these proposed changes is hard to understand. Throughout the last decade the non-profit arts (and most other non-profits) have been subject to great pressures in fund-raising based on the lack of growth (and major reductions) in federal funding for the arts. While federal support has never been a huge factor in most arts organizations budgets, it had been growing at a pace that would eventually have made this support a solid partner with the other funding sectors: corporations, foundations, and individuals. With arts suport hovering at 4% or 5% of most theatres budgets for many years, much greater pressure has been put on the private sector. And while many have attempted to respond, the reality is that the private sector cannot make up the difference. Furthermore, the support of the federal government has always been targeted for stimulating the artistic growth of theatre institutions, not just their organizational stability.

The results of this is that non-profit theatres have had to look for other means of support from earned income sources, beyond the box office. As it is, ticket prices have increased 100% in 8 years at our institution. We cannot burden our audiences further without completely eliminating a large section of the population from having the ability to attend our productions.

(312) 443-3811 200 South Columbus Drive, Chicago, Illinois 60603

In the non-profit theatre at least, I have difficulty even understanding the concept of "Unrelated Business Income." As I understand the legal organization of our institution, we are non-profit and all income generated by the institution goes back into its programs and activities. No individuals disproportionately benefit from the income generating activities of a non-profit institution. If a non-profit is generating earned income and returning it to achieve the institution's mission it should be congratulated, not taxed.

I would think, given the current climate for federal support to the arts, and non-profits in general, that there would be encouragement to find other creative ways of generating earned income. Instead, we are threatened with taxation that lowers our income and decreases our resources for the creation of art, and, additional administrative costs to handle what will likely be a complicated set of reporting requirements.

I hope that the committee will take a long look at the nature of non-profit organizations, the climate for federal support of the arts and other non-profits, and the illogical nature of these proposals. Thank you for your consideration.

Sincerely,

Roche Schulfer
Producing Director

RS/cjb
cc: House Ways and Means Subcommittee on Oversight: Representatives Pickle, Rangel, Jacobs, Ford, Anthony, Flippo, Dorgan, Schulze, Frenzel, Thomas, McGrath

STATEMENT
OF
GOODWILL INDUSTRIES OF AMERICA, INC.
ON
DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

APRIL 15, 1988

GOODWILL INDUSTRIES OF AMERICA, INC. (GIA) appreciates this opportunity to comment on the discussion options relating to the unrelated business income tax (UBIT) currently under consideration by the Subcommittee.

GIA is a national nonprofit corporation, tax-exempt under Section 501(c)(3) of the Code, serving individuals with disabilities and others with special needs through 177 member vocational rehabilitation facilities in North America and 44 affiliates in 30 countries outside North America.

Each of these 177 autonomous, community-based, nonprofit organizations, which are also tax-exempt under Section 501(c)(3), provide a variety of vocational rehabilitation services to individuals with disabilities and other barriers to employment, including job training, vocational evaluation, transitional employment, independent living skills, career counseling, and private sector placement assistance. For individuals with severe disabilities for whom a job in the competitive market is not a realistic expectation at their present level of training, Goodwill Industries may provide paid employment in a structured, "sheltered" environment in accordance with the special wage provisions of the Fair Labor Standards Act. Goodwill serves individuals with a broad range of vocational disabling conditions, with mental retardation/ mental illness the largest category of primary disability. In 1987, the Goodwill Industries network served 83,721 individuals in our vocational rehabilitation programs; employed 78,025 people with vocational disabling conditions in Goodwill facilities, used-goods retail outlets, and industrial and service contract programs; and placed 13,957 individuals into competitive, private sector jobs.

While the majority of discussion options outlined in the March 31 press release would have no apparent direct impact on the operations of local Goodwills, we are concerned that some of the options could negatively affect our vocational rehabilitation efforts depending on how the options are ultimately constructed in legislative recommendations. We will confine our comments to those discussion options which, in our opinion, require clarification as to the intended application, if any, to nonprofit vocational rehabilitation facilities such as Goodwill Industries.

I. "SUBSTANTIALLY RELATED" TEST

We strongly believe that the current "substantially related" test to determine whether nonprofit organization's revenues are exempt from UBIT continues to have conceptual merit and should not be altered. The option under discussion to replace the substantially related standard with a subjective "directly related" test would serve no purpose, as this new standard would create considerable uncertainty without providing the Internal Revenue Service or tax exempt organizations with additional guidance on which income-producing activities are subject to UBIT. While the current substantially related test has been criticized for its broad scope, there is at least a large body of case law and IRS rulings that contribute to fair and consistent application of UBIT law and regulation. Replacing the substantially related test with a directly related standard would only produce confusion and years of litigation.

Similarly, the second discussion option -- determining whether each income-producing activity "standing alone" is tax-exempt -- would not appear to differ significantly from the current "fragmentation" rule, under which an activity does not lose its identity as a "trade or business" simply because it is "carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related" to an organization's exempt purpose. We believe this fragmentation rule adequately differentiates between those activities which are subject to UBIT from those income-generating activities which are tax exempt. In addition, this "stand alone" test could cause severe hardships for nonprofit vocational rehabilitation facilities such as Goodwill Industries and directly diminish the number of individuals who receive vocational services.

Fees received from state vocational rehabilitation agencies for the provision of services for individuals with disabilities (at no cost to the individuals) would presumably remain tax exempt under this test. However, income generated by the sale of goods produced or services performed in Goodwill's industrial and service contract programs utilizing individuals with disabilities form an integral part of a vocational rehabilitation training program. We are concerned that this discussion option could be construed as applying UBIT to income generated by the sale of these goods and services. Current law exempts the sale of these goods or services as long as the activity is no larger than necessary to carry on the exempt function (vocational rehabilitation) of the organization. Accordingly, we strongly urge the Subcommittee to retain current law in this area and reject consideration of this "stand alone" test.

The Subcommittee's specific discussion options on which UBIT would be imposed appears to be the most workable approach for Congress to clarify the parameters of the substantially related test. However, we are concerned that the Subcommittee has chosen to characterize those activities as "inherently commercial." In order for Goodwill to fulfill its charitable mission, industrial and service contract activities are necessary to provide a work environment that enhances Goodwill's ability to provide realistic job training and work experience. It is critical to note that Goodwill does not pursue industrial and service contracts operations for financial gain, a critical element, we assert, in any activity that can be labeled "inherently commercial." In fact, our economic analysis of these contract operations (provided to the Subcommittee last year) indicates Goodwills lose 18 cents on every dollar of revenue generated on these industrial and service contract programs. We strongly urge the Subcommittee not to characterize specific UBIT applications contained in the discussion options as "inherently commercial." Rather, legislative recommendations should make clear that imposition of UBIT on specific activities represents clarification of the current substantially related test.

While none of the specific discussion options appear to be directed at Goodwill Industries' vocational rehabilitation programs, we do have comments on several of the options:

A. GIFT SHOP/BOOKSTORE INCOME: This option, in part, would apply UBIT to "off-premise" catalog sales. GIA offers for sale through a catalog certain low-cost promotional items (e.g., coffee mugs, pins, banners, etc. bearing the Goodwill logo). Sales of these items are limited to Goodwill agencies and are not offered to the general public. We assume that the intent of this option is not to tax these types of sales, and clarification by the Subcommittee on this concern would be appreciated.

B. SALE/RENTAL OF MEDICAL EQUIPMENT/LABORATORY TESTING/PHARMACEUTICALS: We believe the Subcommittee should distinguish between free or low-cost sales or rentals provided by nonprofit human service organizations from those programs for which participants pay full-cost. The distinction is an important one. Although a limited number of Goodwill agencies engage in activities which may fall under this discussion option, we urge that UBIT not be imposed on these sales/rentals at a cost subsidized by the organization in order to make these items or services readily available in the community at an affordable cost to individuals for whom full-cost purchase or rental is not economically feasible.

For example, a Goodwill may provide a wheelchair to an individual that will allow participation in a vocational training program. The cost (sale or rental) of the wheelchair to the individual would be heavily subsidized by Goodwill, and the individual would not pay full-cost. Fees received by the Goodwill in this type of situation should not be subject to UBIT.

C. HEALTH/FITNESS/ATHLETIC ACTIVITIES: GIA has no comment on this discussion option.

D. TRAVEL AND TOUR SERVICES: We request that the Subcommittee clarify the intent of this option. Some Goodwill agencies provide low-cost, specialized transportation services for individuals with disabilities who are inadequately served by public transportation. Often the transportation equipment is acquired through government grants (federal, state, or local). We assume that the Subcommittee does not intend to tax these types of transportation activities conducted by Goodwills for individuals with disabilities as a necessary part of their training or vocational rehabilitation.

E. ADJUNCT FOOD SALES: Increasingly, Goodwills are operating food service vocational training programs in response to industry demand for qualified workers. In the course of these training programs for individuals with disabilities, Goodwills may operate cafeterias for Goodwill clients, employees, volunteers, or at times, for other individuals as part of a program to help provide nutritious meals to people in need (e.g., the elderly). There are several Goodwills who operate cafeterias that are open to the general public. In these situations, individuals in a vocational training program are provided with realistic job experience as a result of their contact with the public. As discussed above, food sales in conjunction with operation of a cafeteria form an integral part of the rehabilitation process, and we believe the Subcommittee should make clear that these types of food sales are exempt from UBIT when the activity is a component of a vocational training program, and the sales are no larger than necessary to carry out the rehabilitation process.

F. VETERINARY SERVICES: GIA has no comment on this discussion option.

G. HOTEL FACILITIES: GIA has no comment on this discussion option.

H. ROUTINE TESTING: While the intent of this option appears to be directed at routine laboratory testing, we are not clear if it would apply to the variety of vocational evaluations provided by Goodwills to individuals with disabilities throughout the rehabilitation process. In addition, Goodwills may perform evaluations of workers' compensation claims for insurance companies for which the organization receives a fee. Again, we assume that these types of activities, which could conceivably fall within a definition of "routine testing," are not intended by the Subcommittee to be subject to UBIT.

I. **AFFINITY CREDIT CARDS**: GIA has no comment on this discussion option.

J. **ADVERTISING**: GIA has no comment on this discussion option.

K. **THEME/AMUSEMENT PARKS**: GIA has no comment on this discussion option.

L. **ADDITIONAL SPECIFIED ACTIVITIES**: Please refer to GIA's objections to defining certain activities as "inherently commercial" outlined above.

II. CONVENIENCE EXCEPTION

Activities conducted by Goodwills are generally not exempted from UBIT on the basis of the current convenience exception. Accordingly, repeal of the convenience exception would not appear to impact the Goodwill Industries network.

III. "REGULARLY CARRIED ON" TEST

Under current law, this test provides the Internal Revenue Service and tax-exempt organizations with considerable guidance on whether certain activities may be subject to UBIT. For human service organizations such as Goodwill Industries, this test is primarily applied to a variety of fund-raising activities. In the absence of this test, the IRS and nonprofit organizations would need to determine if a sporadic or annual fund-raising event would be properly classified as a "trade or business," whether "substantially" all of the work was performed by volunteers, and whether the activity involved the sale of goods, substantially all of which were donated.

For example, a common fund-raising activity among Goodwills is an annual dinner/dance affair conducted by the organization's volunteers. In some cases, the Goodwill's paid staff may also be involved in limited aspects of the event. Conceivably these activities could be called a "trade or business." If the "regularly carried on" test was repealed, the IRS have to examine each event to determine whether the ratio of volunteer support to paid staff time satisfied the substantiality requirement.

GIA believes that repeal of the "regularly carried on" test would cause administrative burdens and compliance confusion. The current requirement that a trade or business be regularly carried on in order for UBIT to be imposed should be retained by the Subcommittee.

IV. ROYALTY EXCLUSION

This discussion option, which would exempt certain arrangements from the royalty exclusion, has the potential for creating substantial new problems in defining "related." For example, it is unclear under this option how to treat situations where a national tax-exempt organization develops and copyrights a product that is used by its tax-exempt member organizations in their operations, and the national organization then enters into a royalty arrangement with a taxable entity to market the product to the public. Is the fact that the product was developed primarily by the national organization for use by it members in their exempt operations sufficient to meet the "related" test, or would the revenue received by the national organization from its arrangement with the for profit entity be subject to unrelated business income tax? This option, we believe, requires further clarification as to the application of the "relatedness" test.

In addition, the royalty discussion option fails to address those situations in which a tax-exempt organization allows the use of its name, for a fee, by a commercial organization to collect used goods, which donors believe are for the direct benefit of the charitable organization. In these situations, the donors take a charitable contribution deduction but, in fact, the goods are sold by the commercial organization and only a small portion of the earned revenue goes to the charitable organization. As discussed in greater detail in GIA's statement to the Subcommittee last year, we believe that this type of situation violates the intent of Congress in establishing the donated goods exception to unrelated business income and should not be permitted under the royalty exclusion.

V. DEDUCTION FROM TAXABLE UBIT

As the current "specific deduction" of $1,000 allowed against unrelated business income has not been increased since its enactment in 1950, an increase in the deduction to $10,000 appears to be reasonable, and GIA supports this Subcommittee option.

VI. UNRELATED DEBT-FINANCED INCOME

GIA has no comment on this discussion option.

VII. SUBSIDIARIES AND JOINT VENTURES

GIA has no comment on this discussion option.

VIII. ALLOCATION RULES

We do not agree that the deduction against unrelated business income for proportionate depreciation and general overhead costs for unrelated business purposes should be eliminated. These deductions are permitted for for-profit businesses and we do understand the rationale behind eliminating them for unrelated business activity conducted by nonprofit organizations. Disallowing these deductions would be discriminatory and would result in a disproportionate tax burden imposed on nonprofit organizations when compared to for-profit firms.

IX. TAX INFORMATION REPORTING

In its statement to the Subcommittee last year, GIA supported more detailed reporting of income-producing activities as a means of improving compliance and enforcement. We also supported increased data collection by the IRS to better determine revenue sources of tax-exempt organizations and their basis for treating those revenues as exempt form UBIT. The discussion options appear to be reasonable and we support them.

- - - - -

Again, Goodwill Industries of America, Inc. appreciates the Subcommittee's consideration of these comments. Because of the complexities of the issues involved, we urge the Subcommittee to again solicit public comments from the nonprofit and for-profit sectors once these discussion options are drafted into legislative recommendations. Our staff is available to assist the Subcommittee in any way when questions arise on the impact of UBIT changes on the ability of Goodwill Industries to continue to provide vocational rehabilitation services to individuals with disabilities.

GREAT LAKES THEATER FESTIVAL

Performing at the Ohio Theatre/Playhouse Square Center and the Alma Theater /Cain Park

1501 Euclid Avenue
Suite 250
Cleveland, OH 44115
216 / 241-5490

Gerald Freedman
Artistic Director

Mary Bill
Managing Director

April 11, 1988

Robert J. Leonard, Chief Council
Committee on Ways and Means
U.S. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

As managing director of the Great Lakes Theater Festival I am writing to the House Ways and Means Subcommittee on Oversight to inform the Subcommittee of the harmful effects on this theater if the options currently being examined regarding the unrelated business income tax become law.

The Festival, a not-for-profit, professional classical theater, is an integral part of the cultural and educational life of Cleveland. The Festival carries an accumulated deficit of $635,000 and has been able to come close to balancing its budget in the last few years only through economies from cooperation with other arts institutions and income from new endeavors.

Sharing mailing lists, advertising income and royalties from licensing property rights are a few of the ways that GLTF has managed to survive. An effort now underway to eliminate the deficit will fail unless the Festival is free to pursue avenues of income and economies which have become vital to sustain a balanced operating budget.

The Great Lakes Theater Festival, along with many arts institutions across the country, is in a precarious position. Only through the combined extraordinary efforts of management and trustees has this theater survived. Avenues which have helped us fill the gap caused by decreased government support and the resulting competition in tapping other funding sources must not be closed if we are to continue to serve our cities.

Sincerely,

Mary Bill

Mary Bill
Managing Director

MB:kl

April 15, 1988

The Group Health Association of America, (GHAA) takes this opportunity to comment on the discussion options developed on unrelated business income tax (UBIT) by the Subcommittee on Oversight of the House Ways and Means Committee.

GHAA is the national trade association for organized prepaid health care systems, representing approximately 70 percent of the nearly 30 million people enrolled nationwide in over 700 health maintenance organizations (HMOs). Among the GHAA membership, the number of non-profit plans and the number of for-profit plans is nearly equal, however, non-profit HMOs enroll twice as many people.

An HMO provides comprehensive prepaid health care services to its members with an emphasis on prevention of illness and treatment in an outpatient setting. By its nature and by law, an HMO provides health care services to enrollees who reflect the age, social and income characteristics of the HMO service area. Care to members is usually provided by physicians affiliated by employment or contract with the HMO.

Non-profit HMOs are organized and operated for the purpose of serving the health care needs of their members. GHAA is concerned about the potential impact of several of the UBIT discussion options. Although some of the changes proposed state clearly how they will or will not apply to non-profit hospitals, they are not clear on the application to non-profit HMOs. Such provisions must be clearly written to treat HMOs the same as hospitals.

A brief discussion of our major concerns follows.

I. Substantially Related Standard

B. Medical Equipment and Devices, Laboratory Testing and Pharmaceutical Drugs and Goods

It would be inappropriate to apply UBIT to income from sales or rental fees from outpatients and non-patients of HMOs for providing pharmaceutical drugs, medical equipment and devices and laboratory testing. This exemption from the UBIT application is made for hospital inpatients and certain outpatients. There is a clear analogy between such patients and HMO members. Like hospitals, HMOs provide or arrange inpatient and outpatient services. The majority of HMO patient encounters occur in outpatient settings which greatly minimizes cost. As a result, HMOs are able to provide a comprehensive set of benefits which usually includes a prescription drug program (provided at a discount to HMO members), eyeglasses, hearing aids, lab testing and in some cases, the rental of medical equipment. Providing such items are clearly substantially related to the exempt purpose of the organization to provide health care services. HMOs provide these services almost exclusively to their members. Non-member use is insubstantial and typically occurs because some former HMO members want to maintain a relationship with certain HMO physicians or because some non-members find the HMO facilities conveniently located. An HMO exemption for such income should be included if this change is implemented.

I. C. Health, Fitness, Athletic and Recreational Facilities

GHAA believes this proposal should be clarified so that UBIT would not be imposed where an HMO includes a prescribed course of medical treatment such as physical therapy which might include excercise programs such as swimming and weightlifting. These services are made available only to HMO members and would be medically indicated.

I. H. Routine Testing

It is not appropriate for UBIT to be applied to HMO income which is derived from routine testing services. These services are provided to HMO members in a manner analogous to hospital inpatients. Their provision to HMO members is mandated by federal and/or state law. An exception is provided under this discussion option for such mandates. It should clearly be available to nonprofit HMOs.

III. "Regularly Carried On" Rule

If an activity by a nonprofit organization is not conducted on a regular basis it does not provide unfair competition to forprofit organizations. Therefore, to repeal this exception creates new, unwarranted administrative burdens requiring the nonprofit organization to monitor infrequent activities. We oppose the proposed change.

VII. Taxable Subsidiaries and Joint Ventures

The proposed option to aggregate activities and income of subsidiaries would be an unwarranted penalty on tax-exempt organizations. Subsidiaries of a tax-exempt organization engaging in forprofit activities are currently subject to taxation. Aggregating the income and activities of controlled subsidiaries in order to apply the purpose test does nothing toward preventing unfair competition between tax-exempt and taxable entities and instead potentially penalizes tax-exempts by revoking their tax-exempt status for no apparent reason. Additionally, aggregation completely disregards the corporate structure of parent companies and their subsidiances for nonprofit organizations, while forprofit organizations use the same structure for their own tax and business reasons. More appropriate, is that rules related to the taxation of unrelated business income of tax-exempt organizations should place the unrelated business activities of tax-exempt organizations on the same economic (and thus competitive) basis as taxable entities.

VIII. Allocation Rules

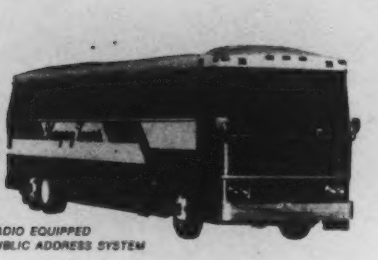
GHAA opposes the proposed option to revise the allocation rules. The proposal does nothing but alleviate an apparent administrative burden for the IRS.

Difficulty in applying a reasonableness test is not a sufficient reason to treat tax-exempt organizations differently from taxable entities by disallowing a deduction for overhead and depreciation. The proposal is such that taxable entities would be unfairly advantaged because tax-exempt organizations could not deduct from revenues necessary and appropriate overhead incurred to produce the revenue. The problem is in determining the correct amount of allocated overhead. A proper solution should correct this problem and not eliminate the entire issue.

In conclusion, GHAA believes the Subcommittee does not intend to penalize nonprofit HMOs for providing health care services primarily in an outpatient setting and that the Subcommittee understands that the services the HMO provides are for the benefit of its members - either directly or substantially related to the exempt purpose of the organization. The exceptions provided for nonprofit hospitals under several discussion options clearly recognizes this concept. These exceptions must in many cases, be clearly defined to apply to nonprofit HMOs. In addition, as discussed, there are several proposals which would create additional administrative burdens for nonprofit organizations while not achieving the UBIT "goal" of assuring that nonprofits have no competitive advantage over forprofit organizations.

We would be happy to answer any questions the Subcommittee might have about our comments. Thank you for the opportunity to express our views on this important issue.

Leslie A. Rose
Deputy Legislative Director
Group Health Association
of America



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April 15, 1988

Dear Congressman Pickle:

I want to commend you and the Ways and Means Subcommittee on Oversight for the time and effort you have devoted to the issue of unfair competition from tax-exempt organizations. As a for-profit tour company which has experienced first hand the serious problems associated with commercial competion from tax-exempt organizations, I can assure you that your efforts are most appreciated.

I am aware that the Subcommittee is considering a set of discussion options for addressing unfair competition. All of these options represent important steps in the right direction. One particularly significant option is to apply the Unrelated Business Income Tax (UBIT) to certain specified activities, including tour and travel services. These activities are commercial in nature. Therefore, if a tax-exempt organization engages in these, they should be treated as taxable activities. This is an extremely fair approach in that it provides an equitable and consistent method of addressing commercial activity, regardless of the type of organization carrying out that activity.

I encourage you to support the options now being considered by the Subcommittee. In doing so, you will be striking a blow for fairness in the marketplace and you will be providing a great service to countless struggling small businesses across America.

Sincerely,

Brian Hagey
President

BH:sc

CHARTERED BUS SERVICE FOR GROUP TRAVEL

Statement regarding effect on museums of possible changes in Unrelated Business Income Tax.

Offered by Von Del Chamberlain, Director,
Hansen Planetarium, Salt Lake City, Utah.

I request that the Committee on Ways and Means carefully consider the growing financial problems of museums in light of discussions on possible changes in UBIT. The financial resources of museums have been diminishing at a time when it is becoming increasingly more expensive to maintain, let alone improve, quality museum services.

Some museums have recognized these problems and attempted to deal with them through creative expansions of their own fine programs. Hansen Planetarium is an example of a facility and staff attempting to maintain its financial needs by the sale of its outstanding educational materials. We have developed quality educational products and made them available to schools, other museums and individuals. The sale of these products, both within our own gift shop and through a mail-order catalog, has increased the impact of our educational efforts, as well as helped to contain our need for tax funding. We operate through local County government, receiving support from our community through property taxes.

If we are required to pay income taxes on the sale of these educational products, the revenues we have realized will very likely disappear. There is not much profit from these sales, to begin with, and all profits are turned back into our educational programs. This loss of revenue will force us to either decrease our services or request an increase of tax support. A request for increase in taxes is sure to be unsuccessful. The result will be the decrease in our ability to provide the educational services we exist for. It will also force us to terminate our production of educational products, which will mean that the items we now make available to others will no longer be available.

I, therefore, urgently request that you not make it even more difficult for us than it already is by imposing additional taxes upon organizations which exist entirely for community educational and cultural enrichment.

Thank you very much for your consideration in this matter.

REALTOR®

GREATER DALLAS BOARD OF REALTORS,® INC.
2989 North Stemmons Freeway • Dallas, Texas 75247
(214) 637-6660

JIM HARRISON
Administrative Assistant

April 14, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Although employed by a 501(C)(6) organization, the following comments reflect my personal opinion and not a formal position of the organization.

In addition to objecting in general to the Ways and Means Committees' intrusion on the nonprofit, tax exempt, service sector, there are some specific options being considered that I strongly object to.

Members belong to an organization like ours to receive services and benefits which will assist them in being more professional and better capable of serving their prospects and clients.

Not all services are suited for all members, and therefore, dues should not include services which will not be utilized by all members. Dues should more basically be set to cover the organizations administrative and operational expenses as well as the cost to provide services utilized by all members.

Services which benefit only a certain segment of the membership should charge be on a cost recovery basis, and only those members who utilize those services should have to pay for them.

Properly invested association assets can provide interest income which will help keep membership dues down and allow members to have more disposable income to purchase additional services which will help them better serve their clients and attain greater professionalism.

Trade shows and other similar activities are often budgeted to bring in a surplus of revenue over expenses to offset the cost of providing other services which would otherwise be cost prohibitive; as well as to help underwrite the cost of operations when association dues do not otherwise provide sufficient revenue to cover expenses.

Associations, like the one I work for, do not produce budgets to create profits, but to provide products are services to the full membership which are affordable and effective, with the least impact on their dues. To accomplish this there are services that break even, services which operate at a deficit, and services which operate at a surplus to compensate deficit funded services.

In its search for revenue, Ways and Means has forgotten why organizations like ours were given tax exempt status' in the first place.

If reviews were conducted of the entire organization as it functions financially, as was obviously done when tax exempt status were provided, Ways and Means would discover that associations benefit their members directly by prudent cash management and effective financial design.

No single activity of our organizations can be scrutinized fairly! Only a complete review of all financial activity will clearly reveal the intent of any single activity.

Respectfully submitted,

Gerald James Harrison
2989 N. Stemmons Frwy
Dallas, Texas 75247
(214) 637-6660

Statement by the Health Industry Distributors Association, Regarding Unrelated Business Income Taxes (UBIT), House Ways and Means Committee, Oversight Subcommittee, April 15, 1988.

The Health Industry Distributors Association represents over 420 firms which provide medical and surgical supplies to our nation's hospitals, physicians, alternate sites for the delivery of health care, and to patients in their homes. HIDA's president, Paul Simmons, testified before the Oversight Subcommittee of the Ways and Means Committee on June 26, 1987 concerning the for-profit activities of non-profit organizations, particularly hospitals. As stated at that time, HIDA has reviewed price lists and merchanding materials demonstrating these for-profit activities of non-profit hospitals with committee staff. We are pleased to provide these additional remarks in response to the March 31, 1988 press release.

In 1938, non-profit hospitals were originally grantes special product purchasing privileges under the Non-Profit Institutions Act in light of their "eleemosynary" role providing charity care for the poor, but not to compete with private firms in areas other than institutional hospital care. Now, these hospital activities in buying and reselling products in general competition with private firms are draining tax dollars out of our economy and abusing special non-profit privileges in order to support expansionist forays into areas far removed from their mandate of in-hospital patient care.

As outlined by HIDA in its testimony of June 26, non-profit hospitals often enjoy access to below-market prices for medical equipment and supplies because of the hospitals' exemption from the Robinson-Patman Act under the Non-Profit Institutions Act. Of course, this exemption is premised on the hospitals' "own use"(and excludes their resale of products for any non-hospital institutional use) of products purchased under this exemption. However, this stricture is often ignored by hospitals in their desire to make profits or to bind more tightly to them their referring physicians. For a hospital to undersell a commercial distributor when it has bought products at a price 20 to 50 percent less than the distributor pays (even when the distributor purchases at like or greater quantity) requires neither merchandising skill nor administrative efficiency. Even the most inefficient hospital distributor organization will undersell the efficient market-oriented private firm distributor when the hospital organization buys at such advantageous rates and has access to other advantages related to non-profit status.

Hospitals have other non-profit advantages of which they are making full use in their for-profit activities: the access to tax-free capital accumulated by the parent organization which can be utilized in new ventures; the ability to subsidize personnel or other start-up costs out of hospital-paid personnel or subsidized rent; in some cases, the use of buildings and property exempt from the local property taxes and other expenses incurred by private distributors.

These subsidies represent a loss to federal or local governments of the revenues which would be contributed to the economy by the for-profit private firm.

These activities are weakening and in some cases destroying private firms; weakening our economic system through inefficient sheltered distribution, including anti-competitive, subsidized ties between hospitals, physicians and patients; sheltering the resulting distribution systems from the fair competition which creates economic growth; and depriving governments of the revenues generated by for-profit firms.

HIDA recommends:

-- Any non-profit health care organization or hospital which obtains more than five percent of its gross revenues from activities other than the care of patients treated in the hospital should be ineligible for tax exemption.

-- All revenues from sales or rental of medical equipment or supplies to out-patients or to persons not patients of the hospital should be subject to UBIT. In addition, regulations must be tightened and enforcement assure that taxes are not evaded on these activities by shifting to the for-profit subsidiary costs incurred by the non-profit hospital for personnel, facilities or supplies.

The Health Industry Distributors Association would welcome the opportunity to elaborate upon these recommendations at the next hearings expected by the Oversight Subcommittee on this troubling issue.

Hearing Aid Associates
~~24 Watchung~~ Avenue 325 Somerset St.
Plainfield, New Jersey 07060
(201) 756-5227

Joseph J. Iacono - Regina R. Persiano
Licensed Hearing Aid Dispensers
State of N.J. - Lic. #105 - #155

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

To the Honorable Robert J. Leonard:

It has come to our attention that competition between commercial for-profit firms and tax-exempt organizations is increasing. Clients we have served in the past by our for-profit firm are now being steered to the tax-exempt and not-for-profit facilities by nursing homes and doctors for products and services which they offer at an attractive price.

You may ask, what is unfair about this situation?

1. The non-profit facility may pay no federal, state or local taxes on profits made from sales of products and services.

2. The non-profit may be tax-supported.

3. The non-profit may be exempt from normal taxes such as sales tax, inventory tax and property tax.

4. The non-profit operates using rent-free facilities and a work-force paid in part or in whole by public funds in hospital clinics.

In summary, we are asking for your support on the following solutions:

Prohibit the non-profit facilities in competing with for-profit businesses.

Deny non-profit tax status to facilities which are competing with our for-profit business which are definitely affecting our livelihood.

We would appreciate your awareness to bills processed through Congress on the aforementioned subject in the near future.

Sincerely,

HEARING AID ASSOCIATES

#155

[Identical letter submitted by:
Joseph J. Iacono]

Comments regarding
Discussion Options
Unrelated Business Income Tax

William F. Sandbach
Executive Director
Hearing Aid Association of California
1330 21st St., Suite 206
Sacramento, CA 95814
(916) 441-0108

The Hearing Aid Association of California strongly supports the repeal of the "substantially related" test and its replacement with a "directly related" test. It is clear that many non-profits in California are now engaged in the direct sale of hearing aids to the general public, and that this activity was not contemplated in their original charter. This is a patently commercial activity which should not enjoy tax-exempt status, yet the "substantially related" test permits it.

We do not believe that non-profits should be engaged in the sale of goods and services which are readily available from the private sector, and therefore support option IB, the application of UBIT to all sales and rental income of medical equipment and devices (including hearing aids). etc.

We support the repeal of the "convenience" exception with a possible exclusion for inpatients.

We support the repeal of the "regularly carried on" test.

While our comments above are specifically addressed to those areas of the current tax laws which affect the sale of hearing aids by non-profits, we respectfully urge the committee to strongly consider each of the options listed in Press Release #16.

No single item in existing tax law permits the proliferation of commercial activities by non-profits which exists today. Rather, it is the combination of broad loopholes in the tax codes which enable almost any organization which wishes to do so to maintain tax-exempt status while competing directly with the private sector, offering an identical line of goods and services, and enjoying the competitive advantage which tax-exempt status provides.

Most small business owners support those non-profit entities which are broadly community-based, and provide services to the disadvantaged, the elderly, youth groups, and others. We support them philosophically and we support them financially.

In California, and we are sure, in other parts of the country, many non-profits have expanded their original objectives for purely financial reasons; they are not filling a role which is not being taken care of by the private sector; their price structure is no different from that of the private sector; they are "non-profit" only because they have applied for, and received non-profit status from the IRS.

Simple equity demands that this situation be corrected. The budget deficit demands that the loopholes be closed or drastically tightened.

We believe that the need for a sweeping change in the tax laws is indicated, and we urge the Committee to make these changes one of its top priorities.

Hearing Aid Center
466 N. Market Blvd.
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Chehalis, WA 98532
(206) 748-8646

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Preliminary Discussion Options UBIT & the Nonprofit Organization

Dear Mr. Leonard,

Please include me in the support of options regarding reform of the Unrelated Business Income Tax system that applies to nonprofit organizations as recently released by the Honorable J.J. Pickle.

In my local area a not for profit hospital maintains a retail hearing aid facility open to the general public. They advertise commercially in local news media, send out direct mailers to prospective patients, and offer open houses in direct competition with for profit privately owned hearing aid establishments located here also. While general competition is good for the consumer, it is difficult if not impossible to compete with a not for profit hospital which currently has sufficient funds to be buying out the for profit hospital in the area.

I urge you to apply UBIT to all hearing aid sales income of nonprofits. They are doing business for profit under the cloak of nonprofit and enjoying many tax exempt benefits of such organizations.

Please repeal existing "convenience" exemptions for patients of such facilities or recognize patients as inpatients only.

Thank you for your attention, and please commend the Subcommittee for proposing an excellent package of reform measures.

Jan Divorne

Jan Divorne
Hearing Instrument Specialist

JD:kl

cc: Honorable J.J. Pickle
U.S. Representative
Chairman of the House Ways & Means
Oversight Subcommitte
Cannon House Office Bldg.
Washington, D.C. 20515

Honorable Don Bonker
U.S. Representative
434 Cannon House Office Bldg.
Washington, D.C. 20515

National Hearing Aid Society
20361 Middlebelt
Livonia, MI 48152

HEARING AID CENTER
578 LOUDON RD RT9
LATHAM, NY 12110

783-1348

APRIL 13, 1988

ROBERT J. LEONARD, CHIEF COUNSEL
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BUILDING
WAHINGTON, D.C. 20515

RE: REFORM OF THE UBIT SYSTEM THAT APPLIES TO NON-PROFIT GROUPS.

DEAR MR. LEONARD,

I WISH TO COMPLIMENT THE SUBCOMMITTEE ON ITS EXCELLENT PACKAGE OF REFORM MEASURES WHICH WOULD APPLY TO SO-CALLED "NOT FOR PROFIT" ENTERPRISES. I WOULD ENCOURAGE THE SUBCOMMITTEE TO INCLUDE ALL THESE MEASURES IN ITS FINAL REPORT.

I AM ESPECIALLY CONCERNED ABOUT THE 5 HOSPITALS AND THE HMO IN OUR AREA WHICH DISPENSE HEARING AIDS AT THE SAME UNIT PRICE THAT I DO BUT WHO ARE EXEMPT FROM PAYING ANY TAXES ON THIS INCOME. THESE "NOT FOR PROFIT" ENTERPRISES HAVE SEVERAL BUILT-IN UNFAIR COMPETITION ADVANTAGES BUT WHEN THEY ARE COMPLETELY EXEMPT FROM PAYING THEIR FAIR SHARE OF TAXES ON THE ENORMOUS AMOUNTS OF REVENUE THEY REAP IT ADDS INSULT TO INJURY.

IT IS GRATIFYING TO KNOW THAT YOUR SUBCOMMITTEE IS LOOKING OUT FOR "THE LITTLE GUY". PLEASE KEEP UP THE GOOD WORK. THANK YOU.

VERY TRULY YOURS,

DANIEL F. MARTIN, SR.

HEARING AID SALES & SERVICE, INC.

Luther C. Repass — Dealer & Fitter #00036

P. O. Box 53
Dublin, Virginia 24084
Phone 674-4889

Janice Anderson — Dealer & Fitter #00262
— Board Certified —
National Board for Certification in Hearing Instrument Sciences

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Reform of the Unrelated Business Income Tax system

Dear Congressman Leonard,

I would like to express my thanks to you for proposing such an excellent package of reform measures. I sincerely hope that all of these measures make it into the final report. I should hope that it will also apply to all hearing aid sales income on nonprofits.

A month ago, I had a Mother call and ask if I would fix her son's hearing aid. She told me that he had been fit with the hearing aid at the University seven miles away from my office. I had the choose of letting this child go without hearing until the University came back from spring break ,or I could see him myself. The smile on the child's face when he could hear again told me I had made the right chose,but the thoughts behind that chose were negative.My tax dollars helps support this University. I am in effect subsidizing my own competition ,and with having to maintain a full time office and pay every tax imaginable, I can not effectly compete with that competition. I am certainly pleased that you are addressing this issue and hope that my comments help in keeping the package intact. Thank you.

Sincerely,

Janice Anderson

Janice Anderson

Member Virginia Society of Hearing Aid Specialists, Inc.
Member National Hearing Aid Society

Hearing Aids Company

An organization devoted to serving the hard of hearing

BONE AND AIR CONDUCTION
CHURCH AND THEATRE HEARING EQUIPMENT
ALL TYPES OF BATTERIES
AUDIOMETERS
GARMENTS
TESTERS

512 MEDICAL ARTS BUILDING
PHONE 218 - 722-4367
DULUTH, MINNESOTA 55802

HOME APPOINTMENTS
Mrs. E. W. Lundblad, Manager

April 11, 1988

Honorable J. J. Pickle
U.S. House of Representatives
Washington, D.c. 20515

Thank you, Honorable J. J. Pickle for considering our plight in reference to Unrelated Business Income Tax system that applies to non profit organizations.

I am a sole proprietor in a town of less than 100,000. It does not seem fair that state paid employees running an organization Like a state hospital or University should compete with us. Their salary goes on even if no one needs a hearing aid. Naturally they can sell for less as all money over the cost of the Hearing Aid (and supplies) goes tobuy the so called"goodies" or in some one's pocket. Where I have to pay for the Hearing Aid and supplies, rent lights, insurance, taxes plus my own expenses before I can show any profit.

One example--I sold a regular customer a replacement Hearing Aid when he needed a new one and charged him my usual charge. A couple of months later he was tak en to the University Hospital for an operation. While there they suggested he see the Audiology Department for a Hearing evaluation. When they found jt was a new Hearing Aid they asked what he paid for it. They were up in arms when he told them as their prices were so much less. They told him to take it back to me and they would get him one for so many dollars less.

I realize I have competition and I'll put my products and expertise against any of them that have the same expenses as I. But to bid against a non profit organization who needs only the price of the Hearing Aid to take a customer away from me is not fair. Besides my taxes help to pay their salary.

So please Honorable Pickle help save our small businesses.

Thank you.

Sincerely,

(Mrs.) E. W. Lundblad

Hearing Associates, Inc.

UPTOWN PROFESSIONAL BLDG.
SUITE 100, 2045 N. THIRD STREET
HARRISBURG, PA 17110

TELEPHONE 234-7067

April 13,1988

Honorable J. J. Pickel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Honorable Pickel:

We would like to commend the Subcommittee for proposing an excellent package of reform measures for the Unrelated Business Income Tax systems that applies to non-profit organizations.

We encourage you to apply Unrelated Business Income Tax to all Hearing Aid sales income, of non-profit organizations,as these are in direct competition with small businesses, who pay taxes.

In our area, we must compete with the Polyclinic Hospitals Speech and Hearing Center. Since they began dispensing, we have lost about 10% of our sales, which results in fewer tax dollars.

We also encourage the Subcommittee to repeal the existing convenience exemptions for patients or recognized patients, as inpatients only.

Thank you for your consideration.

Sincerely,

Frank E. Gable

Frank E. Gable,BC HIS

Evelyn L. Bele

Evelyn L. Bele, BC HIS

cc/ Congressman George Gekas
Congressman Bill Goodling
Congressman Richard Schulze

Miracle-Ear Center
Authorized Dealer

Hearing Services of Tennessee, Inc. • 2120 Crestmoor Road • Nashville, TN. 37215 • 297-3939

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
US House of Representatives
1102 Longworth House Office Bldg.
Washington, DC 20515

April 13, 1988

Re: Reform of UBIT System

Dear Mr. Leonard,

I am thrilled to know that someone is sympathetic to the needs of the small business community competing with non-profit organizations.

The proposed reform package is excellent...one that should be presented in its entirety.

As an Audiologist/Hearing Aid Dispenser now in private practice, I feel the pressure and unfair competition of non-profits quite intensely. There are several specific areas in which I have a keen interest.

1.) The existing "Convenience" exemption for patients should be repealed or recognize patients as inpatients only.

2.) UBIT should be applied to all hearing aid sales incomes of non-profits.

I've been on the non-profit side of dispensing (as a student) and know first hand that the community is being given sub-standard treatment by these dispensaries. In Nashville, the Bill Wilkerson Speech and Hearing Center (BWSHC) is a nonprofit organization dispensing hearing aids. There are, in my opinion, many problems with the non-profit arrangement of such a facility.

1.) Most, if not all, non-profits are set up as teaching facilities. The average patient has a less than 30% chance of seeing a licensed and trained hearing health care provider. They are charging prices significantly over the product costs for the product and services. I have seen countless patients who were inappropriately fit by BWSHC... they had been told that a comparable product and service could be offered at a lower price.

2.) BWSHC boasts the most up-to-date technology and research facilities. I speak to people all the time who have been dissatisfied with the treatment by students.

3.) We pay tax dollars to support a facility who is in direct competition with us and undercutting our prices. They actively advertise to our potential customers in such local periodicals as Senior Sentinel, Active Lifestyles, and the Tennessean (example enclosed).

4.) Examples - We sold a hearing aid to a Mrs. Anderson who we referred for medical attention prior to fit with the instrument. One of the people at Vanderbilt (affiliated with BWSHC) told her she could get the hearing aid cheaper there because they were non-profit; She cancelled her order with us. We sold a hearing aid to a Mr. Luck who was content with the instrument until he learned from someone at BWSHC that he paid too much. They told him they could get him one much cheaper that would do the job. They explained that as non-profit they could save him money. The list goes on and on......

5.) Credentials.... Because they label and advertise (see enclosed advertisement) themselves as non-profit, BWSHC utilizes the tax status to aggressively convey the appearance of superior credentials. I have the same credentials as their instructors who don't even see the majority of the cases.

6.) Because BWSHC is now providing the same FREE hearing seminar that I have been providing (also FREE), I'm finding closed doors that would otherwise be open. I went to a scheduled program through St. Henry's Cloister (a local church development) only to find out that BWSHC had been there one month earlier discussing their hearing aid services.

7.) When trying to become a provider for Care Choice (a Tennessee HMO), I was told they had no need to pay competitive prices because BWSHC could provide the product cheaper.

There is no logical explanation as to why I should have to support, through tax dollars, the competitive expansionist efforts of BWSHC or other facilities like them.

If a facility is non-profit they should use the funds appropriately and not take advantage of their tax status to cheat the small business community out of our hard-earned living.

Research and education are inherent to the nature of non-profit organizations. There is a need for non-profits to fill societal voids that are financially infeasible for the private sector; in filling these voids they deserve special tax status. They do not deserve to get preferential treatment when they compete (aggressively in this case) in the areas that the private sector can service well. As is common knowledge, the small business is responsible for most of the new job development in this country today. An assist to small business will allow this trend to continue and grow. The government, I would hope, would not intend for this abuse of non-profit status to continue. This is a crucial hour for the small business survival fight against the non-profits. Your support is vital.

Thank you for your time and assistance.

Sincerely,

Sheri

Sheri W. Kirshner, M.A.,CCC-A
Audiologist

Higgins Armory Museum 100 Barber Avenue Worcester, Massachusetts 01606 (617) 853-6015

April 15, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20505

Dear Mr. Leonard:

With great concern and even alarm I write to you in regard to proposed changes in business income tax laws which would have a profound impact on the financial position of museums in this country.

Over the past decade and a half, as operating costs have risen dramatically and state and federal budgets have tightened, museums have responded creatively and energetically to increase their operating revenues and go from deficits to balanced budgets. Taking lessons from the for-profit sector, we have evaluated our business assets and have expanded activities and areas which hold the greatest promise of increased income. Merchandising goods and services which extend and promote the museum mission have been the single most important area for us. The Museum Store of the Higgins Armory Museum accounts for 15% of our total income. As with other museums, sales of books, souvenirs, reproductions and children's items carry the educational message home and account for significant amounts of revenue. The proposed changes in the definition of business-related income for charitable and nonprofit organizations threaten this mainstay of institutional support.

Museums operate cultural and educational programs for the benefit of the public. We do not amass profits to be distributed among owners or shareholders. Where revenue now exceeds (or promises to exceed) expenses, the money is used to extend services to the public and to insure our continued existence for the public.

I strongly urge the Committee on Ways and Means not to adopt proposed changes in the "substantially related test" or to increase taxation of catalogue sales and tour travel and other mission-related services. Museums operate under various limitations and conditions - some imposed by our public mission and others related to our small scale. Federal laws should encourage Museums to be more self-supporting by promoting new areas of activity, not prevent museums from entering and developing new business activities.

Thank you for this opportunity to outline my concerns and for your consideration of my views.

Sincerely,

John F. Stevens
Director

JFS/ps

HILLMAN HEARING AID CENTER, INC.

W. R. Hillman, Certified Member National Hearing Aid Society
58 East Main St., Middletown, N.Y. 10940
PHONES: 914-342-5200 OR 914-342-0304

Robert J. Leonard,Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

April 12, 1988

Dear Sir:

As a Hearing Aid specialist and established over the years, I am very much concerned about hospitals selling and fitting hearing aids. That particular hospital is subsidized with federal money and do not pay taxes like we do as individual business men. I am not only concerned about the unfair competition but mostly about the lack of service the hospital gives the hearing aid patients.

Once they fit a patient with a hearing aid they forget about the proper guidance and follow up service. The patients requiring service have to wait weeks to get an appointment, in contrast we are open 6 days a week. People requiring service just walk in and will be given service immediately. I request you give this your earnest consideration.

Yours truly,

W R Hillman

William R. Hillman

WRH:javd

F. WHITNEY JONES CONSULTING SERVICES, INC.
FUND-RAISING COUNSEL
1000 West Fifth Street
Winston-Salem, North Carolina 27101

April 11, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

Why would we, as a people, choose to unreasonably hinder the ability of our not-for-profit institutions to derive a vital portion of their support from so-called unrelated business income?

Competition for grants, gifts, gate receipts, and endowment income is as strong as ever. I believe we must permit appropriate income-producing activities to realize support for our non-profits. My reading of Mr. Pickle's press release #16 (re: UBIT), and related information, indicates consideration is being given to dramatically revise our handling of such income, and I appreciate the opportunity to register my opinion.

Until two weeks ago, I was a Museum Director for six years, at Historic Bethabara Park, in Winston-Salem, North Carolina, and a Museum Educator for six years prior to that. As well, I developed museum reproduction craft items for Old Salem, Inc., in Winston-Salem, North Carolina. I am currently President of the North Carolina Museums Council, and serving on the Advisory Board of the Federation of North Carolina Historical Societies. None of that may make me an expert, any more than that I am now a Professional Fund-raising Consultant to not-for-profit organizations, but I do have an opinion.

The full costs of supplying the public with our many services and benefits of not-for-profit institutions cannot be met by admissions at the front door. At Old Salem, only one third of the annual budget is met by gate receipts. Who can supply the other two thirds? The answer is: a complex and delicately-balanced program of revenue production from a broad array of sources. Those sources must include unrelated business income.

Each year, the museum community sees its governmental funding options threatened. New tax laws have changed the game rules for private sector support for culture and the arts. Last October's market "adjustment" affected corporate giving to non-profit causes. Yet all the while, consumer spending seems on an upward trend. Therefore, why should not non-profits be allowed the natural and suitable opportunity of income-production offered by unrelated business income activities? I believe the public supports allowing non-profits these methods of meeting rising and ever-demanding costs of staying viable.

If there are cases of abuse of current statutes, then let us tighten the grip of enforcement, not make the majority suffer by disallowing a privilege abused by only a minority. In our democratic society, we must not lose sight of majority interests. In this case, I believe the vast majority of non-profits are consciously working to use the system well, not to take unfair advantage of it.

No more than foreign trade sanctions are a long-term solution to keeping American business interests healthy, inappropriate restrictions on non-profits' opportunities to support their many and noble causes and purposes are not long-term solutions for addressing the perceived threat of unrelated business income activities to the commercial sector. Let the marketplace determine the winners.

In summary, I am hopeful that Congress, beginning with representative Pickle's committee, will carefully consider how it can encourage non-profits to best meet their costs - and therefore fulfill their missions - and not discourage an otherwise attractive and highly appropriate source of revenue: unrelated business income.

Thank you for allowing me a forum, and I stand ready to assist in any further way which may be helpful.

Sincerely,

William Hinman
Senior Consultant, F. Whitney Jones Consulting Services, Inc.
President, North Carolina Museums Council

HBI

April 12, 1988

The Hon. J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

Dear Chairman Pickle:

Historic Bethlehem Inc. is concerned about the possibility of taxation of revenue-producing activities administered by non-profit organizations, specifically the discussion being held by your subcommittee on options relating to unrelated business income tax.

As chairman of the Museum Shop Committee for HBI, I write to inform you and your committee members of the importance of revenue-earning through Shop sales in meeting our annual operating budget for educational and cultural programs.

We urge you to maintain specifically the "Substantially Related" Test, Convenience Exception, and "Regularly Carried On" Test." HBI's Museum Shops offer for sale items related to the 18th Century Industrial Area, the development of Bethlehem's economy through manufactured goods, local history, and domestic furnishings as exhibited and interpreted in the John Sebastian Goundie House. Our properties are listed in the National Register of Historic Places and are a valued cultural resource for the entire Lehigh Valley.

Thank you in advance for your acknowledgement of the importance of institutions such as ours and our ability to generate earned income through sales in our Museum Shops.

Sincerely,

Ruthella Sherman, Chairman
Museum Shop Committee

RS:mbb

cc: The Hon. H. John Heinz, III
The Hon. Arlen Specter
The Hon. Don Ritter

HISTORIC BETHLEHEM INC.
459 OLD YORK ROAD
BETHLEHEM, PENNSYLVANIA 18018
(215) 691-5300

HISTORIC
LANDMARKS
FOUNDATION OF
INDIANA

3402 Boulevard Place
Indianapolis, Indiana 46208
317 926 2301

Eli Lilly (1885-1977)
Founder
Officers
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Chairman
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Vice Chairman
J. Reid Williamson, Jr.
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Mrs. John O. Servaas
Mrs. Alfred J. Stokely
Fred C. Tucker, Jr.
George M. Waller
John R. Walsh
Richard B. Wathen
Herman B Wells

12 April 1988

The Honorable Andrew Jacobs, Jr.
1533 Longworth
U.S. House of Representatives
Washington, DC 20515

Dear Andy:

The proposed changes included in Press Release #16 from the SubCommittee on Oversight, Committee on Ways and Means, on discussion options relating to the Unrelated Business Income Tax could have a negative impact on Historic Landmarks Foundation of Indiana's established mission. Several of the proposed changes would impact either established or future programs designed to educate the public with respect to historic preservation. The criteria of specific activities being "inherently commercial" is not valid and would lead to the curtailment of many worthwhile activities. The adoption of the test criteria "directly related" instead of "substantially related" would also be damaging to this organization's ability to carry out its various programs and activities.

One of our most successful ways of reaching the public is through our tour programs in Indianapolis. These tours through the historic areas of the city provide a means of educating the public regarding historic preservation and its value in the urban environment. The proposal, in item 1.D, clearly states that such activities would become unrelated business income. We feel that such activities are clearly related to our goal of education and therefore are not commercial in nature but for the public good.

Another area of concern is item I.A, in which the activities of a museum bookstore could become taxable in certain situations. These stores provide a unique outlet for the dissemination of literature dealing with historic preservation. To make it a taxable transaction would inhibit the ability of this organization to provide this information to the general public.

The allocation rules established in Section VIII would not allow a deduction for general overhead or depreciation. We feel that this is unfair to separate out these specific costs as if they would exist without the business purpose for which they are incurred. Depreciation of equipment used in a bookstore, or a van used for guided tours, are two examples of the type of assets that would be depreciated and should be allocated to their own cost centers. Marketing and accounting services are overhead costs that would not be incurred if the program itself was not being carried out.

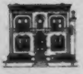
Sincerely,

J. Reid Williamson, Jr.

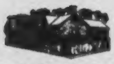
/rf

cc: Robert J. Leonard
David Wildes

Historic
Southwest
Ohio, Inc.



HAUCK HOUSE — 812 Dayton Street
(513) 721-4506



SHARON WOODS VILLAGE — Hwy. 42,
Sharonville (513) 563-9484

P.O. Box 41475, Cincinnati, OH 45241

April 11, 1988

Hon. J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Re: "Substantially Related Test"

Dear Sir:

I am writing to you on behalf of Historic Southwest Ohio, Inc., of which I am currently President.

We operate a gift, book and souvenir shop in Sharon Woods Village, a tax-exempt non-profit outdoor museum presenting the life and activities of a 19th Century village in Southwest Ohio. The income from our volunteer-operated shop is an integral part of our operating budget.

We are appalled at the progress of the federal government in cutting back the sources of revenue for non-profit cultural enterprises. The opportunities for federal funding through grants have been drastically reduced. The inducements for private giving have been reduced. Now our means for self-help are under attack.

As in the case of current tax law generally, Congress is prone to overlook the complications arising from IRS Regs pursuant to Congressional mandate. We, like so many small organizations, will have to take on an additional accounting burden in segregating UBIT - subject itmes from non-UBIT items and justifying our decisions to an IRS agent.

The substantially related test should be broadened, not narrowed.

I am sending copies of this letter to our local Congressmen, anticipating that this may get to the floor eventually.

Very truly yours,

Frank G. Davis
President

FGD:pm
cc: Hon. John H. Glenn
Hon. Howard M. Metzenbaum
Hon. Thomas A. Luken
Hon. Willis D. Gradison, Jr.

P.S. I add a personal observation for which my organization should not be held accountable: Has anybody projected any figures on how much will actually be wrung out of tax-exempt organizations? How much will be added to the cost to IRS for collection? What are the chances a year from now of raising the tax bracket to 36%, and how much more would this increase the tax take in contrast to this nickel-and-dime fine tuning?

Historic St. Augustine Preservation Board

The State of Florida

April 13, 1988

Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Bldg.
Washington, DC 20515

ATTENTION: Chairman, Honorable J. J. Pickle RE: Press release #16

Dear Mr. Chairman:

I am writing on behalf of the members of the Historic St. Augustine Preservation Board and the San Agustin Antiguo Foundation, Inc. which supports our efforts through 501 (c)(3) status. We are charged with the historical research and interpretation of the Nation's Oldest City.

Because of our not-for-profit status, we are able to continue this much needed cultural program of archaeological and documentary research as well as the operation of the only living history museum on the East Coast interpreting Spanish colonial life. Hundreds of thousands of international and national visitors come to St. Augustine annually and over 20,000 school children visit the Spanish Quarter each Spring.

Because we depend on volunteers, donations and other income for our survival, any additional burden through taxation would severely limit the cultural benefit we provide through our programs. To tax our income from educational trips that we sponsor, museum store sales and investments would impair the progress that we have made to date. The nation's museums and charitable organizations have been charged by the President to become more self-supporting. We do this by producing income that will enhance our programs and enable us to grow and by recruiting the volunteers without whom we could not function. Please help us by not taxing us. We need your support.

Sincerely,

William J. Daniell
Chairman of the Board

POST OFFICE BOX 1987 ST. AUGUSTINE, FLORIDA 32085
(904) 824-3355 (SUNCOM) 821-5455

GEORGE HOLLAND, JR.
AUDIOLOGIST

HOLLAND
HEARING AID CENTER
1914 AVENUE Q – 744-8952
LUBBOCK, TEXAS 79405

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D. C. 20515

Re: Reform of the UBIT
system

Dear Mr. Lenoard:

I represent the second generation of hearing aid people in my family, and my sons are our third generation.

We have been taken advantage of for years by non-profits in Texas for 39 years. Many of the West Texas citizens go to Abilene and/or Houston for hearing aid services, just because the non-profits seem to be cheaper than we are. We could all be cheaper if income taxes were not a consideration.

We lose sales almost monthly to the West Texas Rehabilitation Center in Abilene, and to the Methodist Hospital in Houston.

When your group writes the final report on non-profits, be sure to apply the UBIT to all hearing aid sales income of these non-profits.

None of us mind true competition, as that is the American way. We do mind having to cmpete with those who beg for money on TV, like thses evangelists, then turn around and plead for our clients to come to them for services.

We ask for your support in repealing the existing "conveneice" exemption for non-profits in handling out-patients.

Cordially,

George Holland Jr

George Holland, Jr.
Audiologist

Statement of
Bruce R. Hopkins
Baker & Hostetler
Washington, D.C.

April 15, 1988

The purpose of this statement is to submit comments to the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, on the discussion options relating to the unrelated business income tax, as contained in Press Release #16, dated March 31, 1988 ("Release").

This statement is not being submitted on behalf of any client nor is it submitted as a reflection of the views of anyone in my law firm other than myself.

The principal purpose of this submission is to request that the Subcommittee on Oversight, in formulating its recommendations as to revisions in the federal tax law concerning the treatment of unrelated business activities, accompany its package of proposals with a discussion of the philosophical framework within which its proposals have been formulated.

The tax-exempt community is having considerable difficulty comprehending and meaningfully responding to the proposals in the Release because of the lack of an overall framework of principles within which to evaluate the proposals. That is, the recommendations must be evaluated (and proposed) in some sort of context.

It is clear that the law of unrelated income taxation is evolving rapidly even without action by Congress. The courts have been engrafting a "commerciality" test, and in some instances a "competition" test, onto the existing statutory structure. The existing structure basically regards the activities of a tax-exempt organization as "related" or "unrelated." With the exception of the reference to "commercial-type" insurance in Internal Revenue Code section ("IRC §") 501(m), there is no "commerciality" test in the Internal Revenue Code for determining unrelated activity.

The options in the Release seem to be based upon a "commerciality" standard, irrespective of whether the threshold test is the existing "substantially related" test or the possible "directly related" test. This raises a host of fundamental questions.

The first of these questions is the definition of the words "inherently commercial." While this definition does not necessarily have to be in the statute, the accompanying committee report should explain what the words mean. Does the concept of "inherently commercial" mean both the nature of the activity and how it is carried on? Or does "commerciality" mean only the latter? Is it possible to have an activity be "related" to an organization's tax-exempt purposes and yet be "commercial"? If so, would, under the proposal, the "commerciality" element alone cause the activity to be classified as an "unrelated" one?

Certainly, as to this point, the Internal Revenue Service ("IRS") will require some guidance as to the criteria to apply in determining the presence or absence of "commerciality," and its relationship to the test of "competition." In this regard, I note that the Commissioner of Internal Revenue testified at the hearings last June that the IRS lacks the capability to ascertain what is "competitive" activity.

Second, the concept of "commerciality" seems to presume that, since for-profit organizations obviously engage in "commercial" activities, if the activity is to be found in the for-profit sector, it is an impermissible (taxable) activity when and if conducted in the nonprofit sector. Is this presumption to be the operative rule?

If so, presumably some exceptions would have to be made for traditional activities conducted in the nonprofit sector. Two clear instances of this historical conduct is the operation of nonprofit schools and hospitals, even though there are proprietary counterparts. Thus, presumably, the existence of one proprietary school or hospital would not preempt the field, so that there could no longer be nonprofit (nontaxable) schools or hospitals. Presumably, the same would be true for other institutions, such as museums and libraries.

But what about program activities such as conferences, publications, and consulting? Since there are counterparts of these activities in the for-profit sector, are they "inherently commercial" activities and thus unrelated ones? If so, the "commerciality" concept bears directly on eligibility for tax-exempt status as well as on unrelated income taxation, inasmuch as, in many instances, these activities are primary (if not the only) ones.

What about the new entry of one or more for-profit organizations into a field previously occupied solely by nonprofit organizations? Does that introduce "commerciality" into the field, making the activity taxable when conducted by nonprofit organizations? And does the field become nontaxable for nonprofits only when and if the for-profits abandon that field?

To summarize the point, the tax-exempt community and the IRS needs some guidance in this area if the proposals are to be understood and, if enacted, the rules are to be complied with by tax-exempt organizations and properly enforced by the IRS.

This is not necessarily to advocate a position. After all, this is a capitalist society and perhaps nonprofit organizations are to be secondary to for-profit ones when it comes to similar activities. I hope this is not the case but if it is to be the law then the tax-exempt organizations deserve to know it.

Having urged a response to these questions, I would like to insert some advocacy. The nonprofit sector is a treasured national resource. I will leave to the various nonprofit organizations that are responding to the Release the role of articulating its importance. However, my fear is that, in the pursuit of eradication of something called "unfair competition," Congress is on the brink of severely damaging the independent sector. If this occurs, there will be adverse consequences to society, involving troubles that go beyond the nuances of federal tax policy.

Surely there is a way to have this matter properly resolved. Congress must articulate the rules of demarcation between for-profit and nonprofit activity, so that the rules can be adhered to and enforced. At the same time, Congress would be foolish to cripple the aspect of society that makes this country unique: its nonprofit sector.

I do not join those who vociforously proclaim the advent of the end of the nonprofit world every time there is a proposed statute or regulation that might adversely affect tax-exempt organizations. My fear, however, is that in the zeal to protect "small business" or otherwise address members' pet peeves, the nation's nonprofit organizations will be significantly harmed with no corresponding benefit to society. Even if there was a corresponding benefit, it would be augmentation of the role of government in providing social and other services. While others may champion that outcome (and while that philosophy may underlie some of proposals), I believe it would be a short-sighted thing to do and would dramatically alter for the worse the manner in which the society of the United States of America is organized and operated.

Having asked for clarification of the overall philosophy that lies behind the proposals and having expressed reservations about the reach and import of the doctrine of "commerciality," I will turn to some more specific comments about the proposals.

First, I find the package of proposed new rules relatively modest. I say this for two reasons. First, without getting into specifics, the package could have been far more stringent than is the case. Second, many of the proposals would codify what is already the law (as reflected in cases and IRS rulings). Many in the nonprofit community do not understand these two points. Or, caught up in advocacy, they refuse to acknowledge them. This is not to endorse the package of proposals; it is to put them in a perspective.

Some nonprofit organizations are contending that the proposals are inappropriate because they would deprive the organizations of nontaxable revenue. I believe this is the wrong approach, just as I believe those who advance these proposals in search of taxable revenue are wrong. The arguments against the proposals that should prevail are those that are framed in terms of the harm that would be caused, perhaps inadvertently, to the beneficial programs of tax-exempt organizations. There are, indeed, many adverse ramifications of some of the proposals that are undoubtedly unintended, and I hope that the nonprofit organizations, the programs of which would be harmed, speak up and rationally make their case.

Before addressing some of these ramifications, I would like to address another point the tax-exempt community deserves to understand: how many of these proposals are considered to be codification of what the Subcommittee believes to already be the law.

For example, many in the tax-exempt community are concerned about the proposed allocation rules (item VIII of the Release). Yet the existing law, as reflected in IRC § 512(a)(1), states that only those expenses that are "directly connected" with the unrelated activity may be deductible in determining net unrelated business taxable income. Aside from the interpretation given this statutory rule by the regulations and the courts, how would the proposal be any different from the present statutory standard? Or would it merely clarify the matter?

Likewise, in the royalty area, the distinction has always been between passive and active income (IRC § 512(b)(2)). Thus, for example, if a tax-exempt organization is substantially involved in the marketing of a property in conjunction with another organization that is to pay it a "royalty," the resulting income is a product of an active business enterprise and would be taxable under existing law. The same is true with a "royalty" that is measured by net income, where the tax-exempt organization actively participates in the project. Both situations are active business involvements, constituting joint ventures, that are taxable under current law. The nonprofit community deserves to know the difference between any "new law" in this field and the codification of existing law.

Still another example is the tax treatment of revenue from affinity credit card programs. Although I do not always agree with the law that has developed in this area, I believe that the precedents dictate that revenue derived from affinity card programs is taxable income under present law. (This is true, notwithstanding IRS private letter ruling 8747066, which I understand is not reflective of IRS thinking on the subject.) Is the proposal intended to merely codify present law on this subject?

There is a final point to be made in conjunction with the proposed "inherently commercial" standard. This pertains to item I L of the Release. Is it contemplated that the Internal Revenue Code be amended by adding other specified activities or is it intended to grant to the IRS the authority to denominate other activities as being "inherently commercial"? Particularly if the intent is the latter, the tax-exempt community deserves to fully understand the meaning of the words "inherently commercial."

There are troublesome aspects of the proposals as they relate to fund-raising for charitable organizations. Many fund-raising activities are not taxable under existing law but not because they are "related" activities. A charity ball, auction, car wash, bake sale, theater party, or dinner event is not likely to be an exempt function. But under existing law, it is not likely to be a taxable event, either.

The reasons for this non-taxation in the fund-raising context are many. Perhaps the "business" is operated solely using property that was derived as deductible gifts; the resulting revenue is rendered nontaxable by IRC § 513(a)(3). Or, the "business" is operated substantially through the use of volunteers; the resulting revenue is not taxable by reason of IRC § 513(a)(1).

In many instances, however, the fund-raising event is not taxable because it is not regularly carried on. The proposed repeal of this test would likely render taxable many activities that are today considered nontaxable solely because they are "fund-raising" activities. This law change could adversely affect charity balls, auctions, and other special events where the organization uses compensated assistance. I suspect the proposed law changes are not intended to have this effect. I suspect that many believe that these events are not "trades or businesses" to begin with. However, the IRC § 513(c) definition of that term is sufficiently broad to encompass these activities and make them "businesses" for tax purposes. Therefore, repeal of the "regularly carried on" test could have adverse ramifications for fund-raising charitable organizations.

If the "regularly carried on" test is to be repealed, the definition of the term "trade or business" should be modified to exclude from its perview bona fide infrequent fund-raising activities.

Likewise, I am concerned about the reference to affinity credit card arrangements. As noted above, these are probably taxable under existing law. However, some are reading this item to also relate to commercial co-venturing (an unfortunate use of terminology) arrangements, whether or not they involve the use of credit cards. I hope it is not the intent of the proposal to tax what I believe be gift revenue that is derived from commercial coventuring programs.

I wish to make reference to the proposal (item VII) to impute the income and activities of taxable subsidiaries to tax-exempt parents for the purpose of assessing the ongoing tax-exempt status of the latter. This would eliminate the tax reasons underlying the establishment of taxable subsidiaries by tax-exempt organizations. I am of the view that the use of subsidiaries by tax-exempt organizations is appropriate as long as the primary purpose of the exempt organization is not diluted. After all, these subsidaries pay taxes and there usually are good non-tax reasons for the founding of them. However, the proposal would discourage the formation of taxable subsidiaries by tax-exempt organizations. Perhaps this is the intent of the proposal; if so, it should be forthrightly stated.

I wish to briefly address the proposals to expand reporting to the IRS (item IX). A stated in my testimony before this Subcommittee on March 31, 1988 (as part of the hearing on tax penalties), it is imperative that compliance by the tax-exempt community in the reporting context be improved. Part of the problem lies in confusing returns and confusing instructions. It is important that the reporting requirements be strenghtened (to highlight abuses) and that the forms and instructions be made adequately clear to induce the proper level of compliance (so as to generate the necessary data for ongoing oversight by this Subcommittee and the IRS).

Finally, there is the matter of the revenue to be derived from this package of proposals. As noted earlier, any changes in the law of unrelated income taxation should be based on sound tax policy, rather than a drive for revenue. A revenue estimate for these proposals would be appropriate.

WE LISTEN TO HELP OTHERS HEAR

The House of Hearing Aids

5010 HAMPTON AVE. ST. LOUIS, MO 63109 352-7402

April 11, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

RE: House Ways and Means Oversight Committee Recommendations
Regarding reform of the Unrelated Business Income Tax (UBIT)
that applies to non-profit organizations

Dear Mr. Leonard:

As a licensed hearing aid specialist I commend the Sub-Committee for proposing an excellent package of reform measures that relate to unrelated business income tax (UBIT) as they apply to non-profit organizations.

I also encourage the Sub-Committee to include all of these measures in its final report. I especially urge the Sub-Committee to apply unrelated business income tax to all hearing aid sales and income of non-profit institutions and organizations. The hearing aid sales and income activities of non-profit institutions and organizations are of a very commercial nature. They are identical in nature and characteristics to the activities that we perform as a commercial hearing aid sales and service organization, and have performed for many many years.

Furthermore, we encourage the Sub-Committe to recommend the repeal of the existing "convenience" exemption for patients of an institution, or the existing provision that allows outpatients to be classified as inpatients for the purposes of unrelated business income tax exemption. In other words, just because a person is either an outpatient or an inpatient in an institution for a limited period of time the institution should not have the privilege of considering the sale of hearing aids to them as a non-commercial activity.

To help support my position I am enclosing, herewith, copies of information relative the commercial activities of government supported institutions and not-for-profit entities.

I appreciate the opportunity to submit this information.

Sincerely,

Bernard Barnard

[Identical Letters Also Received By:]
Larry Brethower, Springfield, Missouri
Annete Cook, St. Joseph, Missouri
James W. Gallaher, Hopmeier Hearing Aids, St. Louis, Missouri
Mark Goffinet, M & M Hearing Aid Company, Columbia, Missouri
W.F.S. Hopmeier, Hopmeier Hearing Aids, St. Louis, Missouri
Jim Jones, Jefferson City, Missouri
Homer Miller, Joplin, Missouri
Charles Murdock, Springfield, Missouri
James Shandy, Maico Hearing Aid Center, Cape Girardeau, Missouri
Gregory Sommer, Beltone Hearing Aid Service, St. Louis, Missouri
N. S. Vickery, Farmington, Missouri
Ed Wolfe, Richmond, Missouri

February, 1987

UNFAIR COMPETITION FROM GOVERNMENT SUPPORTED INSTITUTIONS

&

NOT-FOR-PROFIT ENTITIES

Taxes - Various taxes which are paid by small business and are not assessed on the not-for-profit businesses. (See attached exhibit)

Equipment - Hospitals and Universities obtain charitable contribution with which to purchase equipment. They also receive government grants such as the Hill-Burton Grant.

Medicare - Hospitals and Universities bill the hearing testing through Medicare. This practice is incorrect as Medicare does not allow the payment of hearing tests when they are done in conjunction with the purchase of a hearing aid.

The hospitals tell those who call that the hearing test charges can be billed through Medicare.

Education - Continuing education is required by most states in order to renew licensure as a dispenser. There is an institution in our area who puts on an in-house seminar for their employees so that they do not have to pay the expense of outside continuing education.

The cost of outside continuing education is approximately $300.00 to $500.00 per person per year. We are currently spending approximately $5,000 per year on continuing education for our employees.

The in-house continuing education seminars are open to the public, but they charge a fee for the seminar, their speakers are in-part members of their own staff.

Marketing - The hospital can cross market their services, such as sports medicine, optical, etc.. They advertise the "White Coat Image."

Marketing - Although their services are sometimes slow and impersonal, they still have the medical image.

Not-for-profit implys lower price, which is not generally true. (See attached exhibit)

When the not-for-profit organizations were called they stressed that the consumer should look out for the hearing aid dispenser, they should always be tested by a clinical audiologist. They inferred that the hearing aid specialists do not know as much as the clinical audiologist.

This kind of attitude could force the small hearing aid dispenser into hiring a clinical audiologist to be on his staff in order to try to compete with the hospitals and universities. The hearing aid dispenser has to advertise the fact that they have a licensed clinical audiologist on staff in order to give the hearing aid dispenser some credibility with the consumer.

Market Structure

The for-profit small businesses are not holding their own. The volume of hearing aids sold nationwide since 1980 went from 736,642 to 1,268,142, a 73% increase. There was virtually no increase in volume of the for-profit segment of the market.

Most of the increase in volume has been absorbed by the hospitals and universities starting to dispense since 1980, because they are at the point of entry of hearing health care mandated by the FDA Medical Clearence.

Profitability is down in the for-profit sector.

Unrelated Business Income Tax

Unrelated business income means nothing, as the hospital can set up a for-profit branch and still have all the other advantages in competing with the for-profit segment of the market.

Other Professions Affected

The cost structures affect not only the hearing aid dispensers, but also the druggists, opticians and those in the business of prosthetics, all of which are sold in hospitals at reduced prices or at competitive prices with a "profit" to the non-profit.

Cost Structure

The hospitals and universities prices average $475 to $700.00, this includes all testing, evaluations and the cost of the hearing aid itself. The hospitals and universities unbundle their costs, and the information given on the phone is the cost of the hearing aid only, excluding the cost of testing and evaluation. This makes the total cost seem lower.

The cost of the testing and the evaluation is quoted separately and are not refundable if the aid is not purchased. This is not always told to the consumer. The non-refundable costs are usually between $125 and $175.00. (See attached exhibit)

For-profit cost structures include the testing and evaluation costs and the consumer is refunded this cost if the hearing aid is returned.

The hospitals and universities do not have the costs of space, utilities, etc. as an issue. In fact, dispensers of hearing aids in hospitals and universities do not know or understand their cost structures. In a 1986 Survey* conducted by Hearing Instruments Magazine, dispensers in hospitals/universities did not respond to the survey questions on percentage of gross income. spent for operating expenses, advertising/promotion, salaries, cost of product, taxes, and net profit. As many stated, " they do not get involved in the actual business operation." Thus, they either price their services on a gut feel or intentionally below the market.

If hospitals/universities price their hearing aids at normal retail, as many do, they certainly must enjoy a reasonable profit.

* Hearing Instrument Magazine, May, 1986, Vol. 37 #6

COMPETITIVE PRICES

INSTITUTION	DATE STARTED	HEARING TEST	HEARING AID EVALUATION	HEARING AIDS	MISC. COSTS	TOTAL COST
St. Louis Hearing & Speech	Est. 6 Yrs	incl	$53.00	$310-$400	$25.00 OV $30.00 EM	$508.00
Alexian Bros. Hospital	7 Yrs.	incl	incl	$450-$550		$550.00
C.I.D.	5 Yrs.	$60.00	$50.00 each ear	$220-$360		$470.00
Wash. U/Barnes	3 Yrs.	$60.00	$85.00	$360-$470	$50.00 Non-Refundable	$615.00
Jewish Hosp.		$60.00	$66.00 each ear	$150-$300	$175.00 Dispensing Fee	$601.00
St. John's Mercy	7 Yrs.	incl	$65.00	$375-$400		$465.00
DePaul	3 Yrs.	$74.00	$66.00	$300-$500		$640.00
Christian Hosp.		$85.00	$86.75	$337-$475		$647.00
Deaconess	2 Yrs.	$25.00	$60.00	$325-$425		$510.00
St. Mary's Hosp.	1½ Yrs.	incl	$75.00	$345-$435	$25.00 Non-Refundable	$510.00

February, 1987

COMPETITIVE PRICES

INSTITUTION	DATE STARTED	HEARING TEST	HEARING AID EVALUATION	HEARING AIDS	MISC. COSTS	TOTAL COSTS
St. Joseph's		$80.00	$65.00	$312-$450		$595.00
St. Louis Univ.		incl	$65-$105	$340-$400		$505.00
Mo. Baptist Hosp.		incl	incl	$550-$700	$50.00 Non-refundable	$700.00

Additional Information:

1) Hearing Tests and Hearing Aid Evaluations are billed separately and are non-refundable Average cost $125 - $175.00.

2) When you call and ask for the cost of the hearing aid - they quote the hearing aid itself and do not tell you about the required non-refundable hearing test and evaluation ($125-$175)

3) The total cost figure is the some of the highest quoted price of the hearing aid and evaluation.

4) CID stressed that you should go to a clinical audiologist and "had to be careful of the hearing aid dispenser."

5) Some institutions charge an amount if the hearing aid is returned, this amount is over and above the already non-refundable hearing test and hearing aid evaluation costs.

6) All the hospital require that you have a written prescription from an ENT physician, this is an additional cost.

February, 1987

The Trusted Name for Better Hearing®
House of Hearing Inc.
A Division of American Optical and Hearing Aid Centers Inc

HOUSE OF HEARING
618 E MAIN ST
LANCASTER, OHIO 43130

TO THE HONORABLE J J PICKLE, CHAIRMAN
AND

TO ALL MEMBERS OF THE HOUSE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE

PRIVATE ENTERPRISE RETAIL MERCHANTS AND PRIVATE PRACTICE PROFESSIONAL PERSONS NEED THE REFORM MEASURES BEING DISCUSSED REGARDING REFORM OF THE UNRELATED BUSINESS INCOME TAX SYSTEM THAT APPLIES TO NON PROFIT ORGANIZATIONS. WE EXPECT THE OPTIONS BEING CONSIDERED BY YOUR SUBCOMITTEE TO RESTORE A MEASURE OF HARMONY ONCE ENJOYED BETWEEN PRIVATE ENTERPRISE HEARING HEALTH CARE PRACTITIONERS AND THE NON PROFIT SECTOR.

AS THE C E O AND OWNER OF ONE OF OHIOS LARGER HEARING AID COMPANIES, I MANAGE 46 TAX PAYING EMPLOYEES MY CORPORATION CONSISTS OF SIX FULL TIME SERVICE FACILITIES AS WELL AS TWO HEARING AID DEPARTMENTS LEASED THROUGH THE LAZARUS DEPARTMENT STORES (A DIVISION OF FEDERATED) MY CORPORATION DISPENSES HEARING AIDS IN 50 LOCATIONS THROUGHOUT THE STATE FROM 1983 TO 1987 I WAS PRIVELEGED TO SERVE ON THE BOARD OF THE OHIO HEARING AID SOCIETY WHICH IS THE PROFESSIONAL ASSOCIATION REPRESENTING THE INTERESTS OF HEARING AID SPECIALISTS IN OHIO. AS THE SOCIETIES MEMBERSHIP CHAIRMAN I HAD MY FINGER ON THE PULSE OF OUR INDUSTRY MY COMMENTS ARE MY OWN, AND I BELIEVE THEM TO BE AN ACCURATE REFLECTION OF THE STATEWIDE FRUSTRATIONS STEMMINING FROM COMERCIAL COMPETITION WITHIN THE HEARING AID INDUSTRY AND ITS EFFECT ON SMALL BUSINESS

THE SIMPLE TRUTH OF THE SITUATION HERE IN OHIO IS THAT ORGANIZATIONS WHICH ARE NON PROFIT SUCH AS PUBLIC FUNDED OR PRIVATE CHARITY FUNDED AND QUASI STATE AGENCIES AND ORGANIZATIONS INCLUDING SPEECH AND HEARING CLINCS, HOSPITALS AND UNIVERSITIES HAVE BEEN AGRESSIVELY LEVERAGING THEIR TAX EXEMPT STATUS IN AN EFFORT TO DOMINATE AND EVENTUALLY MONOPOLIZE THE DISPENSING OF HEARING AIDS

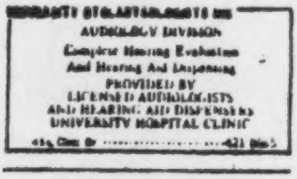
IN 1977 TH F D A MANDATED CONSUMER PROTECTION REGULATIONS FOR THE HEARING AID INDUSTRY THOSE REGULATIONS HAVE SINCE BEEN EXPLOITED BY THE NON PROFIT SECTOR AND A LARGE NUMBER OF PROFIT MOTIVATED PHYSICIANS THE EVOLUTION THAT FOLLOWED HAS BEEN MARKED BY CONSTANT CONFRONTATION POLITICS A NUMBER OF THESE ORGANIZATIONS ARE LEVERAGING THEIR NON PROFIT TAX EXEMPT STATUS AND GAINING AN UNFAIR AND RUNIOUS COMPETITIVE BUSINESS ADVANTAGE. THEIR ADVANTAGE AS A NON PROFIT ENTITY GIVES THEM A PRIMARY POINT OF ENTRY STATUS IN THE EYES OF THE HEARING IMPAIRED PUBLIC THEIR TAX EXEMPT STATUS ALSO GIVES THEM A TOOL FOR ACHIEVING THEIR MONOPOLISTIC ASPIRATIONS

A TYPICAL ON-GOING EXAMPLE OF THE USE OF STATE FACILITIES BY STATE PAID EMPLOYEES TO UNFAIRLY COMPETE WITH PRIVATE ENTERPRISE EXISTS IN THE OHIO STATE UNIVERSITY COLLEGE OF MEDICINE, DEPARTMENT OF OTOLARYNGOLOGY THIS DEPARTMENT IS LOCATED IN THE OSU HOSPITALS CLINIC BUILDING, 456 CLINIC DRIVE, COLUMBUS, OHIO. SINCE EARLY 1980 CERTAIN OF THE DEPARTMENT'S FACULITY MEMBERS, INCLUDING THE DEPARTMENT CHAIRMAN AND OTHER EMPLOYEES HAVE USED THE DEPARTMENTS FACILITIES. MEDICAL EXAMINATION ROOMS, OFFICE SPACE, SOUND PROOF HEARING TESTING ROOMS, HEARING TESTING ELECTRONIC EQUIPMENT, UTILITIES, SUCH AS; TELEPHONE, HEAT, LIGHT AND AIR CONDITIONING, ALSO OFFICE SUPPLIES AND EQUIPMENT - AS WELL AS SUPPORT PERSONNEL, PAID BY THE STATE, TO CONDUCT A THRIVING RETAIL HEARING AID DISPENSING BUSINESS. OF COURSE, AND PERHAPS MOST IMPORTANT OF ALL TO THE SUCCESS OF THE RETAIL HEARING AID SALES OPERATION, IS THE FACT THAT THE REPUTATION OF THE OSU, AND ITS MEDICAL SCHOOL AND ITS HOSPITAL, ALL OF WHICH ARE STATE AGENCIES, PROVIDE A CONSTANT FLOW OF DIRECTLY REFERRED "CAPTIVE" CUSTOMERS FOR HEARING AIDS

THE RETAIL SALE OF HEARING AIDS IS NOT AND SHOULD NOT BE A COURSE OF STUDY FOR STUDENTS IN THE COLLEGE OF MEDICINE. AND THE RETAIL SALE OF HEARING AIDS BY THIS DEPARTMENT IS NOT LIMITED TO SALE TO STUDENTS OF THE UNIVERSITY INDEED, ITS SOLE PURPOSE IS TO SELL HEARING AIDS TO THE GENERAL PUBLIC IN DIRECT AND RUINOUS COMPETITION WITH PRIVATE ENTERPRISE HEARING AID DISPENSERS WHO ENJOY NONE OF THE ADVANTAGES LISTED ABOVE FOR THIS DEPARTMENTS RETAIL OPERATION

THE ADVERTISEMENT WHICH APPEARS IN THE CURRENT ISSUE OF THE TELEPLHONE DIRECTORY CONFIRMS THAT THE INTENTION IS TO SELL HEARING AIDS AND AUDIOMETRIC SERVICES TO THE GENERAL PUBLIC IT

APPEARS IN THE HEARING AID AND IN THE AUDIOLOGY SECTIONS OF THE BOOK A COPY FOLLOWS - TAKEN FROM PAGE 517 OF THE YELLOW PAGES



[illegible]
AUDIOLOGY DIVISION
Complete Hearing Evaluation
And Hearing Aid Dispensing
PROVIDED BY
LICENSED AUDIOLOGISTS
AND HEARING AID DISPENSERS
UNIVERSITY HOSPITAL CLINIC
[illegible]

421-8065 is Also the phone number of the Audiology section of the OSU Dept. of OtolAryngology locAted At the sAme Address

A MAJOR FUNCTION OF OTOLARYNGOLOGY IS THE MEDICAL AND SURGICAL TREATMENT OF THE EAR TO PREVENT OR ALLEVIATE A HEARING LOSS THOSE NOT CANDIDATES FOR MEDICAL TREATMENT OBTAIN THE HEARING LOSS CORRECTION FROM A HEARING AID BECAUSE OF U S. FDA RULE NO 801-421, PERSONS WISHING TO PURCHASE A HEARING AID MUST OBTAIN MEDICAL CLEARANCE BEFORE THEY MAY DO SO ADULTS MAY WAIVE THE MEDICAL EXAMINATION BUT NOT THOSE UNDER EIGHTEEN YEARS OF AGE OBVIOUSLY, THOSE WHO VISIT THE OSU DEPARTMENT OF OTOLARYNGOLOGY FOR THE PURPOSE OF OBTAINING THIS MEDICAL CLEARANCE TO PURCHASE A HEARING AID WILL BE SOLD ONE BY THE DEPARTMENT FACULTY MEMBER OF COURSE IF HE NEEDS SOME MEDICAL OR SURGICAL TREATMENT, ONE OF THE FACULTY MEMBERS WILL SUPPLY THAT ALSO - FOR A FEE

THE FEE FOR TREATMENT OF SOME OF THOSE SENT TO THE OSU DEPARTMENT OF A OTOLARYNGOLOGY/UNIVERSITY OTOLARYNGOLOGISTS INC ARE PAID BY STATE WELFARE AGENCIES IF THE FEES ARE PAID TO THE CORPORATION, THIS AMOUNTS TO STATE FUNDS BEING PAID TO STATE EMPLOYEES USING STATE FACILITIES TO MAKE A PROFIT FOR A PRIVATE CORPORTATION

ANOTHER EXAMPLE OF UNFAIR COMPETITION WITH SMALL BUSINESS EXISTS AT THE LANCASTER FAIRFIELD COMMUNITY HOSPITAL 401 N EWING ST LANCASTER, OHIO 43130 IT MAY BE TYPICAL OF A LARGE NUMBER OF HOSPITALS IN OHIO (LANCASTERS POPULATION IS 40,000)

ZANE HEALTH CARE CORP , PARENT CORPORATION OF THE NON PROFIT LANCASTER HOSPITAL RECENTLY DIVERSIFIED ITS CORPORATE BUSINESS INTERESTS BY ACQUIRING A MILLION DOLLAR RESTAURANT IT HAS SET UP A PRIVATE CORPORATION TO ESTABLISH A CATERING SERVICE AND PLANS ON DEVELOPING RETIREMENT HOUSING ON A PORTION OF THE RESTAURANT PROPERTY ZANE HEALTH CORPORATION RECENTLY PURCHASED THE FAIRFIELD COUNTY VISITING NURSES ASSOCIATION AND RECENTLY DEVELOPED HOME HEALTH RESOURCES INC , A RETAIL OUTLET FOR THE SALE AND RENTAL OF MEDICAL EQUIPMENT AND OXYGEN SERVICE THAT IS OPERATING IN A LOCAL SHOPPING CENTER IT IS WIDELY RUMORED THAT ONE NON PROFITABLE FLOOR OF THE HOSPITAL MAY BE CONVERTED TO COMPETE WITH LOCAL MERCHANTS IN OPTICAL, PHARMACY, DENTAL, HEARING AID DISPENSING AND OTHER INCOME GENERATING VENTURES AS SOON AS THEIR RESTAURANT BECOMES MORE PROFITABLE

THE LANCASTER HOSPITAL IS NOW DISPENSING HEARING AIDS AND ADVERTISES ITS SERVICES IN FULL PAGE NEWSPAPER ADS IN THE PAST, AUDIOLOGISTS EMPLOYED BY THE HOSPITAL HAVE BEEN PERMITTED TO SELL AND SERVICE HEARING AIDS WITHIN THE HOSPITAL, EXCLUSIVELY ENRICHING THEIR OWN FOR PROFIT CORPORATION FROM THE UNBUNDLED HEARING AID PURCHASE PRICE SEPARATE TESTING FEES ARE PAID BY THE PATIENT TO THE HOSPITAL THE PERSONS OR CORPORATIONS WHO DISPENSE HEARING AIDS FROM THE REFUGE OF A PUBLIC FUNDED INSTITUTION ARE NOT REQUIRED TO PAY TYPICAL BUSINESS EXPENSES SUCH AS RENT, PHONE, INSURANCE, WAGES, ELECTRICITY, HEARING TESTING ROOMS AND TESTING EQUIPMENT THERE ARE NO PROPERTY TAXES, FEDERAL STATE OR CITY TAX AUDIOMETRIC EQUIPMENT IS OFTEN PROVIDED BY WELL INTENTIONED ORGANIZATIONS SUCH AS TWIGS, UNITED WAY AND EASTER SEALS

DOUGLAS LEWIS, THE AUDIOLOGIST EMPLOYED BY THE LANCASTER HOSPITAL AUTHORED A FEATURE ARTICLE APPEARING IN MARCH 1988 HEARING AID JOURNAL (THE PRIMARY JOURNAL OF HEARING CARE AND TECHNOLOGY IN THE U S) HIS ARTICLE "A SURVEY OF HOSPITAL AUDIOLOGY AND HEARING AID DISPENSING PROGRAMS" INCLUDED THE RESULTS OF A QUESTIONAIRE SENT TO ALL OHIO HOSPITALS THE TYPE OF RESPONDING FACILITY WAS BROKEN DOWN PROFIT 10%, GOVERNMENT, OTHER 10%, NOT FOR PROFIT 80%

THE FOLLOWING QUESTIONS FROM THAT SURVEY ARE APPROPRIATE

1 IS YOUR FACILITY CURRENTLY INVOLVED IN THE DISPENSING OF HEARING AIDS?
    51% YES
    49% NO
2 HOW LONG HAVE YOU BEEN DISPENSING HEARING AIDS?
    8% LESS THAN 1 YEAR   4% 10-20 YEARS
    55% 1-5 YEARS   8% MORE THAN 20 YEARS
    25% 5-10 YEARS
    88% SINCE 1978
3 DO YOU ANTICIPATE AN INCREASE IN DISPENSING HEARING AIDS BY YOUR ORGANIZATION IN THE NEXT FEW YEARS?
    88% YES
    4% NO
    8% NO ANSWER

THIS "COMMERCIALIZED" NON PROFIT COMPETITION IS HAVING A DISASTEROUS EFFECT ON OUR SMALL TAX PAYING BUSINESS

I ENCOURAGE YOUR SUBCOMMITTEE TO INCLUDE THE ENTIRE PACKAGE OF REFORM MEASURES IN ITS FINAL REPORT WHILE THE PROBLEMS FACING THE SMALL BUSINESS SECTOR ARE WELL KNOWN THE SOLUTIONS OBVIOUSLY ARE NOT EASY

I COMMEND YOUR SUBCOMMITTEE FOR PROPOSING AN EXCELLENT PACKAGE OF REFORM MEASURES

AS YOU MIGHT IMAGINE ITS VERY FRUSTRATING FOR A SMALL BUSINESS TO WATCH PUBLIC SERVICE ANNOUNCMENTS ON TV DIRECTING POTENTIAL CUSTOMERS TO A RESPECTED INSTITUTION THAT APPEARS IN THE PUBLIC EYE TO BE A CUT ABOVE ITS EVEN MORE FRUSTRATING TO REALIZE GENERIC AMBIGUITIES EXIST IN THE TAX CODE ALLOWING THESE NON PROFIT ORGANIZATIONS TO SELL HEARING AIDS IN OHIO THERE ARE MANY COMMERCIAL NON PROFIT ORGANIZATIONS WHO ENJOY THE BEST OF BOTH WORLDS THEY HAVE DEVIATED FROM THEIR CHARITABLE INTENT TO A POINT WHERE CHARITABLE SERVICES CONSTITUTE ONLY A VERY SMALL PART OF THEIR OPERATING BUDGET ITS THAT BLATENT ABUSE THAT BEGS TO BE ADDRESSED THE UNRELATED BUSINESS INCOME TAX NEEDS TO BE APPLIED TO ALL HEARING AID SALES INCOME OF NON PROFITS I ALSO ENCOURAGE YOUR REPEAL OF THE EXISTING "CONVENIENCE" EXEMPTION FOR PATIENTS

THANK YOU IN ADVANCE FOR YOUR CONSIDERATION

SINCERELY

JAMES A NEVINS

HOUSTON
GRAND
OPERA

DAVID GOCKLEY,
GENERAL DIRECTOR

APR 14 1988

April 12, 1988

The Honorable J. J. Pickle
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Pickle:

The recommendations of the House Ways and Means Subcommittee on Oversight in regard to Unrelated Business Income Tax threatens the fiscal health of nonprofit arts institutions.

At a time when support from all levels of government is decreasing and at a time when the corporate sector is decreasing its support while charging arts institutions with "earning" a greater percentage of income, instituting a tax of any amount on the small number of dollars earned to support our programs is at best regressive and at worst punitive.

Please note that in the case of the Houston Grand Opera, the proceeds earned from many of the sources the Subcommittee proposes to be taxed go directly to support a wide range of educational activities directed toward this area's classrooms, and the outreach program designed for adult audiences making up the diverse cultural population of Houston, the State of Texas and the Gulf Coast region.

We have managed to survive a severe economic downturn; we are hopeful that we can continue to maintain our programs during the recovery in Houston. Please do not add to the daunting financial challenge we are already facing.

Thank you very much.

Sincerely,

Dolores Johnson

Dolores Johnson
Managing Director

cc: David Gockley- General Director

HOUSTON GRAND OPERA 510 PRESTON HOUSTON, TEXAS 77002 (713) 546-0200 TELEX: 910 881 5551

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: UBIT System as it Applies to Non-profit Organizations

First let us say that we are pleased to find that the above-mentioned reform measures have been proposed. We hope that all of these will be included in your final report, but of course, strongly support and urge the taxation of all hearing aids by non-profit organizations.

While initial non-profit hearing aid sales were deemed a convenience and a training tool by non-profits, the recent years have found the approach to be extremely capitalistic and on a for-profit basis.

Hearing aid sales are no longer for just the "underprivileged" on a "sliding scale". They are for the public at large and are advertised as such. Note the recent ad from Active Aging and the current yellow pages for the same facility.

The hearing aid pricing is misleading to the public as it is common to unbundle prices and therefore be able to quote low hearing aid cost. The addition of additional items, tests, service, loaner aid during repair, etc., brings the total cost to, if not above, those sold at retail/profit facilities. A summary of this comparision is enclosed. The client is quoted the price of the hearing aid alone and therefore assumes a large difference.

Even in cases of bundled prices, the non-profit exemption allows unfair advantage to groups who have found hearing aid sales to be a source of increased profit in locations where overhead is supported through other divisions and in an economic time where clients are reducing their overall medical visits.

An enclosed advertisement typifies the type of materials being presented to the public from non-profit organizations.

We hope that finally an end can be in view for this unfair pressure on the small business owner. We will wait for further word on this matter.

Again, our appreciation for your efforts.

Ed Hullet
Edward Hullet/Lic. #342

Michael Schroeder/Lic. #751

Casey Edell
Casey Edell/Lic. #762

Marie Unruh/Lic. #429

Walter Zitlow/Lic. #294

Sherry DuPerier
Sherry DuPerier/Lic. #530

Chester L. Weatherly
Chester Weatherly/Lic. #238

Jack L Blue
Jack Blue/Lic. #18

Don Burrell
Don Burrell/Lic. #49

Emma J. Hullet
Emma Hullet/Lic. #531

Dorothy M. West
Dorothy West/Lic. #720

Alan Grigsby
Alan Grigsby/Lic. #341

W. R. Rice Jr
W. R. Rice, Jr./Lic. #407

Woodrow R. Rice
Woodrow R. Rice/Lic. #4

Wesley DuPerier
Wesley DuPerier/Lic. #CE647

Bob Holland
Robert Holland/Lic. #501

Rose Allen
Rose Allen/Lic. #776

Terry Brewster
Terry Brewster/Lic. #212

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• Automatic Background Noise Reduction •

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2400 Jardine Drive • Wichita, Kansas 67219

262-8271

Medicare Assignment Accepted

COMMENTS BY THE MICHIGAN HUMANE SOCIETY AND THE HUMANE SOCIETY OF THE UNITED STATES

The Michigan Humane Society and the Humane Society of the United States wish to comment upon the discussion options with respect to the unrelated business income tax.

Our principal concern centers upon proposed changes to the tax code regarding the provision of veterinary services. In a Technical Advice Memorandum dated August 30, 1984, the IRS found that The Michigan Humane Society's veterinary services to the public at cost plus 10 percent, at reduced rates or for free to owners unable to pay, are related business income. The two organizations believe that changes made in this area of the law could have a significant impact upon the quality and kind of services which animal welfare organizations are able to provide throughout the country.

The two organizations support the retention of the "substantially related" test. They also support subjecting to UBIT specific practices which are clearly not related to the health and well-being of animals. Subjecting to UBIT such practices as boarding, grooming, declawing, ear-cropping, tail-docking and other non-beneficial elective surgery, would create a clear-cut, easy to follow guideline for both humane societies and the IRS. These specific provisions, at the same time, leave as tax exempt the performance of functions vital to a meaningful animal care program.

We would, however, caution strongly against restricting the language of the proposal any further than it stands in option "F", (Press Release #16, page 1). Examples set forth in the most recent draft of Discussion Options (p.7) are, we suggest, unduly restrictive.

The language concerning the spaying and neutering of animals "prior to release from a humane society" would have an extremely adverse impact upon animal welfare. Some eight million dogs and cats are euthanized in the U. S. every year. The ability to spay and neuter pets brought to humane societies from other sources is a significant portion of our charitable work and is a major tool in combating the huge cat and dog overpopulation problem faced in virtually every community of our country. The Internal Revenue Code should not restrict or impose limitations upon animal welfare organizations in their efforts to spay and neuter as large a number of pets as possible.

The example in the larger Discussion Options paper (p.7) concerning "emergency surgery on an injured animal," is also unduly restrictive. While the example falls squarely within the broader language ("measures...for the health of the animal"), the language of the rule should make it clear that other, non-emergency treatment is encompassed as long as it is directed toward the health and well-being of the animal. A failure to so clarify the language would severely restrict a humane society's efforts to protect animal health. Restricting tax exempt veterinary services to only emergency efforts would harm many current animal health programs which, without question, benefit both animals and the community as a whole.

The Michigan Humane Society and the Humane Society of the U. S. strongly support the language of option "F" (Press Release p. 2) which imposes UBIT on "income from certain veterinary services such as grooming, boarding, and elective surgery (emphasis added). We are opposed to the language in the larger Discussion Options paper (p.7) which reads "Apply UBIT to income from veterinary services including grooming, boarding, and elective surgery..." (emphasis added). The difference between the "such as" and "including" language is that in the former instance a clear idea as to what is encompassed by UBIT is provided. This language makes the specific activities subject to UBIT very clear--they are all activities of a like kind. In the latter instance, no guidelines are given. The veterinary services in question "include" those listed, but may also include services of a totally different kind. No true standards are therefore given. Additionally, the first option (the "such as" language) accurately reflects the nature of veterinary services which should be subject to UBIT.

We are opposed to the creation of a "directly related" test. We believe that such a new standard would result in massive relitigation of issues already thoroughly explored. In light of the fact that the "substantially related" test has been the subject of considerable scrutiny by both the courts and the IRS, abandoning that standard for another would create turmoil without any benefit necessarily being derived from the change. Conduct now viewed to be "substantially related" to a non-profit organization's purposes would, in virtually every case, also be "directly related" to the charitable purpose. However, review of the entire issue would be in order because a different test has been imposed. Relitigating, retesting and reviewing settled areas of law would be the only certain result of a change from the "substantially related" to a "directly related" test.

The ability of animal welfare organizations to prevent animal abuse and the corollary issue of promoting a compassionate society have much to gain or lose from decisions regarding UBIT. For this reason, we thank the Committee for its thorough consideration of the matter.

Submitted on behalf of the
Michigan Humane Society and
The Humane Society of the U.S.

April 15, 1988

By: William M Brodhead
William M. Brodhead
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2715 M Street, NW, #300
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Presented by

Donald J. Tebbe, Deputy Executive Director
Illinois Community Action Association
Post Office Box 1090
Springfield, IL 62705
(217)-789-0125

INTRODUCTION

The Illinois Community Action Association is a network of 47 agencies engaged in antipoverty and human service work within the State of Illinois. The membership is primarily nonprofit corporations as well as units of local government and planning commissions. Within the $264,000,000 in combined budgets of our membership are many millions of dollars devoted to economic development within the State of Illinois.

In recent years, the increasing pressure on federal resources has required our agencies to engage in various sorts of enterprises to generate revenues in order to serve their client populations. These range from bake sales and other special events held on a local level up to and including entering into partnerships with the private sector to provide fee-for-service activities. Given this, we do not take lightly the various options relating to the unrelated business income tax and what we see as a very serious and detrimental effect on the nonprofit community.

Replacement of the Basic Standard for Taxability

We are concerned that replacement of the "substantially related" test for a "directly related" test may preclude organizations from participating in various types of fund raising activities. For example, if a local organization wants to participate in the special events, say a chocolate festival, with the fact that holding chocolate festivals is not directly related to their mission, would that preclude them from holding that kind of much needed fund raising activity? We propose that the substantially related test be maintained.

Food Sales

We are concerned about the proposal to tax food sales. In the discussion of the options, it appears uncertain as to whether meal programs, such as food kitchens, senior nutrition sites, or other similar feeding operations which may require some sliding scale of payment of some other form of cash payment, would, in fact, be taxed on that activity even though that activity may be substantially related to the basic purpose of the organization. We are opposed to any attempt to tax food sales that results from activities directly related to the basic purpose of the nonprofit organization.

Advertising

The options as presently written would be punitive to a nonprofit organization as opposed to a for-profit carrying out similar activity. We think it is unconscionable that the Committee staff would propose elimination of this type of fund raising activity. Many organizations use ad books and advertising within their publications to help defray the cost of special events and publications, and are seen by those organizations as yet another fund raising tool that directly relates to their mission. We oppose the taxation of advertising without opportunity to consider appropriate deductions.

Controlled Subsidiaries

Many community action agencies and other organizations engaged in economic development have developed subsidiaries which may result in profit making activity which is incidental to their primary purpose, that of creating jobs for low-income people. We find that the changes proposed by the staff relative to the rule of 50 percent ownership, either individually or in the aggregate, would have a serious detrimental effect on the ability of these agencies to engage in this much needed activity. This activity only takes place because the private sector is unwilling or unable to provide sufficient jobs for low-income people. Through this proposed option the avenue for many people living on welfare to move to a position of making an economic contribution to our society, would be closed. We recommend that the current ownership test for controlled subsidiaries be maintained and that the staff proposal be rejected. Further we find that this proposal is punitive to the nonprofit organization over and above a for-profit organization the same circumstances in that the deductibility of certain interests, rents and other royalties would be denied to a nonprofit subsidiary.

Allocation Rules

Once this again this is an area where the staff proposal is punitive to nonprofit organizations over for-profit organizations in similar circumstances. A deduction for depreciation of dual use of the facilities or for the overhead attributable to unrelated business activities would impose heavier taxes on the nonprofit's subsidiary as compared to a for-profit organization. For purposes of deductibility we recommend that the rules be fairly written so as to treat a nonprofit organization and a for-profit organization in similar circumstances fairly and equally and not be punitive to either.

Miscellaneous Proposals

We find that the taxing of the exchange or rental of donor lists between 501(C)(3) organizations to be unacceptable. Donor lists are a hard won investment developed with a great deal of care and hard work, and the exchange of that between nonprofit organizations should not be a taxable activity. It is very difficult for a nonprofit organization to document the immense costs of developing such lists.

We also find that the taxing of the distribution of low cost items in conjunction with a fund solicitation is yet another detrimental proposal. Would this also include the activities of such organizations such as the Girl Scouts or other organizations which use the sales of low cost items as a fund raising vehicle? We hardly see how this activity could be judged to be "in competition" with the private sector. We recommend that this fund raising method be left untaxed and otherwise available to nonprofit organizations.

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

STATEMENT OF
INDEPENDENT PETROLEUM ASSOCIAITON OF AMERICA
AND

- AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
- ASSOCIATION OF OILWELL SERVICING CONTRACTORS
- CALIFORNIA INDEPENDENT PRODUCERS ASSOCIATION
- COASTAL OIL AND GAS ASSOCIATION
- EASTERN KANSAS OIL AND GAS ASSOCIATION, INC.
- EAST TEXAS PRODUCERS AND ROYALTY OWNERS ASSOCIATION
- ENERGY CONSUMERS AND PRODUCERS ASSOCIATION
- GEORGIA OIL AND GAS ASSOCIATION
- ILLINOIS OIL AND GAS ASSOCIATION
- INDEPENDENT OIL AND GAS ASSOCIATION OF NEW YORK
- INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA
- INDEPENDENT OIL PRODUCERS' AGENCY
- INDEPENDENT OIL PRODUCERS ASSOCIATION TRI-STATE, INC.
- INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES
- INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO
- INDIANA OIL AND GAS ASSOCIATION
- INTERNATIONAL ASSOCIATION OF DESK AND DERRICK CLUBS
- INTERNATIONAL ASSOCIATION OF GEOPHYSICAL CONTRACTORS
- KANSAS INDEPENDENT OIL AND GAS ASSOCIATION
- KENTUCKY OIL AND GAS ASSOCIATION
- LIAISON COMMITTEE OF COOPERATING OIL AND GAS ASSOCIATIONS
- LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS
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- ORANGE COUNTY PETROLEUM ASSOCIATION
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- PENNSYLVANIA NATURAL GAS ASSOCIATES
- PENNSYLVANIA OIL AND GAS ASSOCIATION
- PERMIAN BASIN PETROLEUM ASSOCIATION
- ROCKY MOUNTAIN OIL AND GAS ASSOCIATION
- ROYALTY OWNERS AND INDEPENDENT OIL AND GAS PRODUCERS ASSOCIATION OF ARKANSAS
- TENNESSEE OIL AND GAS ASSOCIATION
- TEXAS INDEPENDENT PRODUCERS AND ROYALTY OWNERS ASSOCIATION
- VIRGINIA OIL AND GAS ASSOCIATION
- WEST CENTRAL TEXAS OIL AND GAS ASSOCIATION

U.S. House of Representatives

Subcommittee on Oversight of the

Committee on Ways and Means

Comments on UBIT Proposals

April 15, 1988

Representing America's Domestic Petroleum Explorer/Producers
For information call (202) 857-4722

U.S. House of Representatives
Subcommittee on Oversight of the
Committee on Ways and Means
Comments on UBIT Proposals
April 15, 1988

Background

On March 31, 1988, the Honorable J.J. Pickle, Chairman of the Subcommittee on Oversight requested comments on the Subcommittee's preliminary discussion options regarding the unrelated business income tax (UBIT).

On behalf of the Independent Petroleum Association of America (IPAA) we wish to comment on the proposed changes in the tax treatment of royalties and net profits interest under the UBIT. Together with the 44 unaffiliated state and regional associations listed on the cover page, we represent the estimated 12,000 independent oil and natural gas producers who account for 90 percent of the wildcat drilling in the United States and 85 percent of all drilling, which results in a majority of the significant oil and gas discoveries.

Proposal by the Subcommittee

Under the Tax Treatment of Royalty Income section the Subcommittee proposes to retain present law for certain non-working property interests. We understand that this proposal would include both royalty and net profits interests. We strongly support this retention.

The holder of a working interest in an oil and gas lease is defined as one who has the exclusive right to exploit the minerals on the land. A working interest is subject to all taxes, operating and other costs and is deemed to be a direct, controlling type of investment and therefore subject to normal income tax. Net Profits Interest is defined as a share of gross production from a property, measured by net profits from the operation of the property. It is "carved out" of the working interest. A Net Profits Interest shares only in a predetermined portion of the revenues after all taxes and operating costs. As such they are treated as passive investments and, for tax exempt investors, are therefore not subject to UBIT. Royalty interests are very similar to net profits interests.

Importance to the Oil and Gas Industry

Tax exempt organizations have almost exclusively restricted their direct equity investments in oil and gas programs to net profits interests. At the end of 1986, direct investment in oil and gas properties by exempt organizations was estimated to be in excess of $1 billion. It appears that pension funds, college endowments, and foundations are prepared to make larger investments in future years in an industry desperately in need of capital but only so long as they are not subjected to UBIT. Many exempt organizations have informed us that, should the tax laws change relative to UBIT, they will withdraw their much needed funds from our industry.

Summary

The ability to acquire net profits interests in oil and gas properties is a significant alternative investment vehicle for tax exempt organizations. In addition, it has been and continues to be an important and growing source of capital for the oil and gas industry. There is legal precedent, as well as long standing Treasury acceptance, of a net profits interest as a right to gross production measured by net profits. Its elimination will not result in increased tax revenues since exempt investors will divert their investments to vehicles not subject to UBIT. Because of this, and because of its historic legitimacy as an investment vehicle for tax exempt organizations and its importance as a source of capital for the oil and gas industry, we urge the subcommittee to retain present law as proposed in the discussion options and not subject net profit or royalty interests to UBIT.

INDEPENDENT SECTOR POSITION ON "DISCUSSION OPTIONS" FOR CHANGING THE UNRELATED BUSINESS INCOME TAX, AS LISTED BY THE OVERSIGHT SUBCOMMITTEE OF THE HOUSE WAYS AND MEANS COMMITTEE

Submitted by Brian O'Connell, President

INDEPENDENT SECTOR appreciates the Subcommittee's willingness to receive written comments and conduct an oral hearing, for we believe that sound legislation can emerge from an open dialogue. INDEPENDENT SECTOR is a non-profit coalition of 650 corporate, foundation, and voluntary organization members with national interest and impact in philanthropy and voluntary action. Its mission is to create a national forum capable of encouraging the giving, volunteering, and not-for-profit initiatives that help all of us to better serve people, communities, and causes.

There are many elements of the proposals that should, we believe, be acceptable to, and even welcomed by, the voluntary sector. In particular, we welcome the options calling for increased reporting -- and particularly the requirement that organizations specify explicitly the reasons they believe that income-producing activities are exempt. Requirements along these lines would not only provide more complete and accurate information for tax policy judgments in a field too dominated by anecdotes. They would also, we believe, increase voluntary compliance by requiring more explicit and conscious attention to unrelated business income ("UBIT") issues.

These comments do not address each of the many specific proposals in the Subcommittee's list of discussion options that relate to specific types of activities. The organizations affected by those proposals will be commenting themselves, from their own perspectives. These comments do address several of the issues of significant importance to many individual groups.

It is most important that when areas are identified as requiring clarification, or where for competitive or "seemliness" reasons Congress decides to tax certain activities, the language used be clear, and directed at the particular problem identified by Congress. The language should not be vague and general, thereby raising questions about the status of programs never discussed or considered by Congress when it enacted the changes. Those issues can be addressed meaningfully only on the basis of a much fuller description of the proposals, preferably in the form of proposed legislative language.

It is clear even on the basis of the summaries of the options listed in the Subcommittee's request for comments, however, that several of the proposals would have very broad potential impact on the independent sector. The proposals present fundamental issues because they would result in changes going far beyond correcting perceived abuses and anomalies to radically altering the way the tax system affects the viability of charities in this country. Four such broad issues, addressed here, are:

1. Proposed alternatives to the "Substantial Relatedness" standard, which present the issue of the overall standard by which to determine whether an activity that produces income for an exempt organization is taxable;

2. Taxation of fundraising and program activities, which presents the issue of whether the UBIT is to be applied far outside the realm of what can reasonably be characterized as business activities;

3. Denial of normal deductions of costs associated with earning unrelated income, which presents the issue of

equality of treatment for non-profits when their activities are taxable; and

4. Taxation of royalties from licensing businesses to use assets created by an exempt organization, which presents the issue of whether to violate the principle of exempting charities' passive income.

I. Overall Standard

The options list included in the Subcommittee's press release indicates that the Subcommittee intends to consider, not only the many specific changes identified, but also alteration of the current overall standard whereby an exempt organization's income-producing activities are not to be taxed unless they are unrelated to accomplishment of the organization's exempt purposes.

We support the position of the Treasury Department in its testimony at the Subcommittee's hearings -- which was also expressed by many members -- that the relatedness test is sound in principle and should be maintained as the general standard, even if it is modified in particular details. The relatedness concept reflects the basic reality that a wide range of the services that educational, religious, health, community, scientific, social service, and other charitable organizations provide will produce "income" in the sense that charges will be made for the services charities provide. However, if tax were imposed on fees for charitable services, like school tuitions, charitable activity itself would be taxed. That would be as inconsistent with the basic principle of tax exemption for charity as taxing donations or endowment income. Since the demise of the "destination of income" test, it has also been national tax policy that the mere fact that funds are received by a charity -- and will be devoted to charitable purposes -- is insufficient for exemption.

Rejecting the "destination of income" test while maintaining the principle of exemption from tax of income derived from charitable activities -- but only from such activities -- requires having a general principle by which to differentiate what kinds of activity to tax. For nearly 40 years, the Code has employed the "substantially related" principle in determining whether it is appropriate to tax a particular activity. That principle has been defined in long-standing regulations as an exacting one, requiring both that there be a causal connection between the activity that produces the income and the organization's exempt benefit. Moreover, the activity must "contribute importantly" to the accomplishment of the exempt purposes. Other safeguards have also been developed. For example, even a related income-producing activity, to remain exempt, must be on a scale no greater than needed to carry out the exempt purpose.

INDEPENDENT SECTOR agrees that there can be reasonable differences about whether the required relationship exists in borderline cases. Where there have been abuses, and even where Congress simply believes a mistake has been made in interpreting the standard, it is entirely appropriate for Congress to modify the interpretation that has been given to the law in the particular areas of concern. We submit, however, that there has been no serious evidence advanced against continuing the basic inquiry required by the current law, which is, "Does the income-generating activity help, in real and important ways, to advance exempt purposes, apart from producing funds for such purposes?"

No doubt different words could have been adopted in 1950 to express the same basic concept. However, in considering changes it is important that the Congress recognize the utility of not altering basic concepts that have been developed and articulated by the IRS and the courts over almost 40 years. The "relatedness" standard has been the subject of countless court decisions and IRS rulings, both published and private; an entirely new standard would lack this developed structure of interpretation and understanding. There is enough uncertainty in the field already; it simply does not make sense, in the name of correcting abuses or responding to specific claims of unfair competition, to change the basic test without a clear justification -- and a clear statement of what is to be put in the place of the familiar concepts. No one's interest would be served by creating a vague new general standard that neither charities nor the IRS will understand until after years of regulation-writing and litigation.

Indeed, if the consideration of a new general standard were to be limited to the two alternatives explicitly listed in the press release, the chief concern is uncertainty about what their adoption would be intended to mean different from current law, apart from a generalized desire to tighten the criteria.

Two specific alternatives are listed in the press release:

-- "Direct" relationship. The first would require that, to be exempt, an activity must contribute "directly" to accomplishment of exempt purposes. Since "substantial" and "direct" are nearly synonymous, any distinction between the current "substantially related" standard and the proposed "directly related" standard would depend on the meaning intended to be given to "directly," not from the change of words. Current law already requires a strong connection between the activity and exempt purposes. Specifically, under the existing "substantially related" test, an activity, to be exempt from UBIT, must have a "causal relationship" to the organization's charitable (or other exempt) purposes and must "contribute importantly" to accomplishing those purposes. Except possibly for a vague sense that any change would imply a tightening, substitution of the word "direct" would merely confuse the issue.

-- Each activity tax-exempt. The second option identified is to require that "each income-producing activity standing alone is tax-exempt." The rule that each activity must be separately considered is already in the current law, which requires a "fragmentation" approach. Under that approach, each separate income-producing activity is analyzed to determine whether it meets the test of contributing importantly to accomplishment of exempt purposes. Indeed, under the current law approach, an item-by-item -- and sometimes customer-by-customer -- analysis has to be made of particular transactions to determine relatedness.

The difference between the proposed standard and the current one would, therefore, be the consequence of requiring that activity be "tax-exempt" rather than the current "related to accomplishment of exempt purposes." Obviously, many charitable activities are such only because of the context in which they occur: Selling candles is not an "inherently" charitable activity, but when votive candles are sold in a Catholic church, the activity clearly contributes to the religious function of the church and the income should be exempt. Logically, an activity that qualifies as "related" under the current standard, i.e., that is causally connected to the exempt purpose and contributes importantly to accomplishment of it, should qualify for exemption in its own right, assuming that the context -- its integral connection to other charitable activity -- is held constant.

INDEPENDENT SECTOR supports the current "fragmentation" doctrine. (1) To the extent that this second option is meant to codify the current "fragmentation" approach, it is unnecessary; and (2) to the extent that it is meant to change the current fragmentation approach -- e.g., by rendering the context of activity irrelevant -- it is bad law and should be rejected.

"Commerciality." Beyond these strong reservations about the two alternatives to the "substantially related" standard that are explicitly identified in the press release, INDEPENDENT SECTOR is concerned about another, even more troubling new standard -- that of "commerciality." Such a standard is likely to be advocated to this Subcommittee, and indeed, certain of the specific options listed are described as taxing specific activities because they are "inherently commercial" in character.

We urge the Subcommittee not to adopt a "commerciality" standard, either as an overall statutory alternative to the "relatedness" test, nor as the supposed guideline for specific changes -- and certainly not as a catch-all label for every change made in particular situations.

A fully sufficient reason to avoid declaring a "commerciality" standard is the inherent vagueness of the term. If "commerciality" means that a non-profit organization should be taxed if it does exactly what for-profit businesses do, if there is no clear connection to its charitable purposes, it simply restates current law. Carrying on normal commercial activities simply to make money is not exempt under current law, as the regulations specifically state.

However, under current law, the mere fact that for-profit businesses provide similar services, although relevant, is not decisive, and it should not be. Virtually all services provided by exempt organizations are also provided, on some scale and to some people in some places and in some ways, by for-profit businesses. There are proprietary schools, for-profit theaters, commercial parks and museums, and privately-owned health care facilities. Many of these businesses provide excellent services -- for the people they find it economically profitable to cater to. But all private businesses, however public spirited, are run to make a profit for their owners. By contrast, charities must, both by state law and by federal tax requirements, be run to serve the public interest, and any surplus -- a relatively rare occurrence -- must be used for the charitable purposes of the organization. From this fundamental difference flow differences in community accountability and accessibility, standards of management, character of services, and organizational standards. The tax law should continue to recognize that when these differences exist, different tax treatment is appropriate. And the mere fact that an activity resembles those of a taxable business does not make it taxable.

Some academic discussions have advocated an even more radical "commerciality" standard under which an activity would be taxable if it were financed substantially, e.g., more than half, by fees for service. This version of the "commerciality" test rests on a fundamental misconception of the character of charitable activity. There is nothing either inappropriate or "untraditional" about charities charging those who can pay for the exempt services they provide. The basic mission of the voluntary sector is to provide services that benefit the public interest, not to provide them free to those who can afford to pay for them. From the earliest history of charity, schools, hospitals, cultural groups, and a host of other charities of the most traditional kind have charged fees for their services to those who can pay. Indeed, even organizations primarily serving the poor have traditionally asked for payment where payment can reasonably be expected, on the sound basis that doing so promotes both dignity and discipline.

Nor is there any support in either history or logic for the idea that the voluntary sector should reduce its fees to avoid being self-sustaining in the delivery of exempt services. The idea that charity must operate at a loss -- especially on an activity-by-activity basis -- is both bad history and bad policy. In any case, as a practical matter, donations can only be relied on where other resources are inadequate. The charitable generosity of the American public is large both in absolute terms and relative to private giving in other countries. The voluntary sector is still, as it always has been, critically dependent on private giving for a very large share of its resources. But what can be raised by pure donations is all too small if compared to the scale of needs. It is even more clear that, under current budget pressures at all levels of government, the public fisc cannot and, indeed, should not, be used to subsidize programs of charities that have the potential to be self-sustaining. In fact, government has been urging the voluntary sector to become more self-financing in recent years.

The demands on both private and public sources of those missions for which charges cannot cover costs already exceed resources. It would be folly indeed to create incentives in the tax law for organizations to lower charges for services that can be self-sustaining and try to turn to donations or government to make up the difference. Taxing income from charitable services would, therefore, necessitate drastic cut-backs in those services.

In short, a "commerciality" standard would be either uncertain in its effect or misdirected in purpose or both, and it should neither be employed as a new or supplementary statutory standard, nor used as a convenient shorthand for labeling all those activities that Congress, for whatever reason, has judged ought to be taxed.

II. Fund-raising and Program

The proposals would go far beyond activities normally thought of as involving the "business" activities of non-profits. They would -- at least as suggested by the brief descriptions now available -- result in tax on many activities that are part of organizations' services and programs, or are part of their efforts to raise charitable contributions.

For example, under these proposals, it appears that tax would be imposed on income from:

-- all off-premises sales, apparently without regard to how selling the products supports an organization's program, such as a scientific society's sales of subscriptions to its journal, or a university press's sales of its books (Option I(A));

-- virtually any activity that involved collecting transportation costs from participants, ranging from a church-sponsored bus trip to a lake for young people to an art tour organized by a local museum (Option I(D));

-- food sales to the public in conjunction with a program activity, such as refreshments at a school sports event (Option I(E));

-- fund-raising events unless goods or services sold were donated or all services provided free; (Such events are now normally tax-free by virtue of the exemption for activities not "regularly carried on," which would be repealed under Option III.)

-- contribution drives in which "premiums," including low-cost items like tee-shirts, are given to contributors; (Such activity would be taxed by the repeal of the "regularly carried on" rule and by the proposal, under Option X, to eliminate, as a "piecemeal exclusion," the specific exemption for "low cost articles.")

-- advertising in programs for performances, sports contests, and fund-raising events. (Such advertising may qualify now as not "regularly carried on," and, in any case, the receipts generally are often offset by the current deduction for costs of the non-advertising content of the program, which would be eliminated.)

It seems extremely unlikely that the drafters of the options actually intended such broad-ranging impact on areas so central to charitable operations and fund-raising, and so completely separated from the issues of active business competition that were the principal focus of concern in the hearings last summer. Nonetheless, to avoid such unintended sweeping effects, proposals aimed at particular abuses should be drafted in a narrow, targeted fashion, and with a sensitivity to legitimate -- and wholly non-competitive -- fund-raising and program practices.

III. Allocation of Expenses

It is no secret that much of the impetus for changes in the UBIT field comes complaints by for-profit businesses that tax exempt organizations should be taxed on income-producing activities to avoid having an unfair competitive advantage. While there is room for debate about the accuracy of the charge of unfair competition in particular cases, we fully agree that where tax-exempts do engage in unrelated business activity, they should be taxed. But the very "fair competition" rationale for taxing them at all also requires that, once a charity's activity is determined to be taxable, the tax should be determined under the same principles that apply to taxpayers generally, so that the charity pays neither more nor less tax than a for-profit business would pay on account of the same income-producing activity.

The discussion options, however, include a number of elements that would deny to charities deductions that would be available to for-profit taxpayers. Among these are the proposals to bar deduction for the cost of the readership content of a publication in determining taxable income on advertising appearing in it (Option I(J)); to tax subsidiaries of exempt organizations on a different basis from other taxable entities (Option VII (3)); and, most strikingly, the proposal (Option VIII) dealing with the allocation of expenses where a facility is used both for exempt purposes and for unrelated business purposes.

Under this allocation proposal, a charity would be allowed to deduct against UBI a proportionate share of its direct costs of operating the facility, such as maintenance, insurance and utilities. However, the charity would not be allowed to deduct any of the indirect costs of operating the facility, such as depreciation and overhead, even though those costs are ordinary and necessary expenses of earning the income in question, and would clearly be deductible under normal tax rules.

INDEPENDENT SECTOR strongly opposes this proposal. It represents a radical departure from existing law, under which a charity is permitted to deduct all costs "directly connected" with carrying on an unrelated trade or business (IRC § 512(a)(1)). In the case of "dual use" facilities -- that is, facilities used both to carry on exempt activities and to conduct unrelated business activities -- expenses must be "allocated between the two uses on a reasonable basis" (Treas. Reg. § 1.512(a)-1(c)). The Regulations explicitly state that such allocable expenses may include "depreciation" and "items of overhead," such as an officer's salary.

Although some disagreements have arisen about what accounting method to use in allocating indirect costs, even the IRS has never contended that such costs should not be deductible at all. To the contrary, the Treasury Department in its June 22, 1987, testimony supported the continued deductibility of these expenses. Deputy Assistant Secretary Chapoton stated:

> [W]e are concerned that [denial of a deduction for indirect costs] might unduly hinder the ability of exempt organizations to acquire new facilities that would only prove economical if some portion of the facility were put to commercial use. Thus, a university seeking to build a new field house or to purchase a powerful computer might be unwilling to proceed unless a commercial use could absorb some of the fixed costs.

INDEPENDENT SECTOR agrees with Treasury that the deductibility of depreciation, overhead, and other indirect costs of dual-use facilities should be retained. The objective of the UBI tax is to ensure parity of tax treatment between non-profits and commercial enterprises. The allocation-of-expenses option would contravene this objective, since it would impose heavier income taxes on a business run by an exempt organization than on a comparable business run by a taxable corporation. There is obviously no possibility of taxes allowing "unfair competition" between non-profit and commercial enterprises if the former receive the same deductions to which the latter is entitled.

Barring a deduction for depreciation and other indirect costs of running a dual-use facility would also produce irrational results. It is well established that a non-profit may deduct depreciation and other indirect costs of running a facility that is wholly used for business purposes. Any other result, obviously, would blatantly discriminate against non-profits. But if all the indirect costs of running a single-use facility are deductible, it makes no sense to say that none of the indirect costs of running a dual-use facility may be deducted. As Assistant Secretary Chapoton pointed out in his testimony, dual-use facilities often represent an extremely efficient mode of operation that benefits non-profits, other users of the property, and society at large. There is no policy justification for creating a tax disincentive to charities' acquisition of dual-use facilities.

IV. Royalties

Option IV(2) would tax the passive income that a non-profit organization derives from royalties on licenses granted for-profit businesses to use property created by the non-profit group. This proposal would have a very strong impact on a few organizations, and result in some increased tax payment for many. However, it is of concern to all charities because it breaches the principle that charities should be exempt from tax on passive income. The royalties proposal is, therefore, inconsistent with the fundamental concept of the UBIT, which is to create an exception to the general rule of exemption only when charities engage in active businesses and then only if the businesses do not contribute importantly to their exempt purposes.

Taxing license royalties would do nothing to advance the policy of insuring fair competition that has been the prime impetus for re-examination of the whole UBIT area, and that has been the essential policy of the UBIT since its origin. In the host of criticisms from the small business community, no one at the hearings -- or, so far as our research can determine, elsewhere -- has made a claim that license royalties are unfair competition. Nor could such a criticism reasonably be made. Tax exempt organizations that receive royalty income do not compete with taxable businesses, but rather provide those businesses with an asset to use.

In addition to being a legitimate source of passive income, licenses serve public purposes. For example, license arrangements are, as Congress has recently recognized by statute, a major way in which technological discoveries made at universities and research institutes can be applied promptly and efficiently in the economy. Licenses are also a way for non-profits to facilitate private industry in distributing materials that -- whether or not they would qualify as "related" in the narrow sense of the statute -- help the charities further their purposes and build their popular recognition.

Royalties, including royalties on licenses to use property developed by the licensing charity, are genuinely passive income, as the Code recognizes by generally treating them in the same way as portfolio income, e.g., for personal holding company purposes. Established legal principles, reflected in both IRS positions and court decisions, require that, for an exempt organization's income from the use of its property to qualify as an exempt royalty, the organization's role has to be strictly that of a passive licensor, with all the production, marketing, and other business decisions in the hands of the taxable licensee. Thus, the royalty exemption encourages non-profits to leave to for-profit business the active realization of the commercial potential of property the non-profits have developed, with the non-profit organization in a strictly passive role. This is precisely the policy the UBIT is supposed to advance.

The fact that the licensed property -- whether a patent, a copyright, or simply good will, and whether a process, a symbol, a character, or something else -- may have been developed in the course of the organization's exempt programs provides no logical basis for taxing the passive income derived from other entities' use of the property. Each aspect of a charity's opportunity to receive income (other than from unrelated business, which is taxable) ultimately derives from its charitable character. When a charity earns endowment income from stocks and bonds, it is invariably true that the money used to create the endowment will have come to the exempt organization because of the value and reputation of its charitable programs. The justification, consistent with the basic competition concern of the UBIT, for exemption from the special tax structure established for unrelated business income -- whether of portfolio income or income from licensing -- is that the role of the exempt organization in earning the income is passive, not that its opportunity to earn the income is unconnected with its charitable program and reputation.

The proposal to tax these royalties derives from a discussion in the Treasury's testimony in the hearings last summer. Treasury is wrong in its claim, made in that testimony, that continued exemption for this sort of license royalty is inconsistent with the general rule that businesses that exploit an exempt function are subject to unrelated business income tax. The "exploitation" regulation at issue imposes tax "when _an organization exploits_ such an intangible [generated in an exempt function] in commercial activities." Treas. Reg. § 1.513-1(d)(4)(iv)) (emphasis added). This regulation applies, for example, where an organization exploits the goodwill of its members in order to sell them products or services at a profit. See, _e.g._, _U.S. v. American Bar Endowment_, 106 S.Ct. 2426 (1986) (sale of insurance).

The "exploitation" principle has absolutely no application to passive license royalties. An exempt organization that earns such royalties is not engaged in commercial activities at all; to the contrary, it has merely agreed to provide an asset that a taxable business may use in the taxable business. A charity does not "exploit" its exempt function when it earns royalty income on property licensed to a commercial enterprise, any more than when it earns interest income on money lent to a commercial enterprise, or rental income on realty leased to a commercial enterprise; the fact that the asset in question (whether intellectual property, money, or real estate) was acquired in the course of charity's exempt activities is equally irrelevant in each case.

The point of the regulation and the "exploitation" concept is that an otherwise taxable and unrelated business actively carried on by a charity does not become exempt because of, in the regulation's words, "the mere fact that the resultant income depends in part upon an exempt function." Taxing passive license royalties would turn the sound "exploitation" principle on its head and say that because passive, normally non-taxable income is derived from an asset ultimately associated with exempt activity, the income should be taxable. This change would be particularly inappropriate in light of the proposal to tax royalties based on the licensee net income, a change which would reinforce the requirement that the charity licensor's role be purely passive.

The illogic to taxing royalty income from property developed by a charity is highlighted by the fact that it would not affect the status of royalty income derived from intangibles not developed in the course of an exempt organization's charitable programs. Thus a charity could get tax-free royalties from licensing trademarks or processes if licensing rights were given to it because of its reputation as a charity -- or, indeed, even if it purchased the rights itself -- but not if such trademarks or processes were developed by its own efforts. There is no rational basis for such a distinction -- nor, within a system that recognizes the need for exemption for a charity's passive income, for taxing either form of royalty income.

Charities, including many with no significant royalty income at all, are deeply concerned that, once the principle of not taxing passive, non-business income is violated, whether in a search for revenue or for some other reason, the precedent will be cited as justification for taxing other passive sources as well.

April 15, 1988

ICIA
International Communications Industries Association
(FORMERLY NATIONAL AUDIO-VISUAL ASSOCIATION)
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April 15, 1988

Chairman J.J. Pickle
House Committee on Ways and Means
Subcommittee on Oversight
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Pickle:

We are responding to your invitation for comments on the Subcommittee's option paper dealing with Unrelated Business Income Tax.

On behalf of the International Communications Industries Association, I want to relay our appreciation to you and the Subcommittee for the time and concern you have devoted to this issue. The five days of hearings, the three-volume set of the hearing record, and the option paper have all communicated to the small businesses in our association that you care and that you are trying to help.

To assist the Subcommittee further, we request an opportunity to testify when you hold hearings on the option paper. ICIA represents the following:

Members	Non-Profit Competitors
Computer dealers	University and Community College computer and book stores.
Video and audio-visual rental companies	Universities, YMCAs, and others which routinely rent out equipment for use in hotels and at meetings outside their organization.
Video, computer, and audio-visual repair centers	Multi-county cooperatives which contract to do all school repair work.
Computer software publishers	Universities, school districts, and the Minnesota Educational Computing Corporation.
Video, film and transparency publishers	Universities which sell similar products via catalogues, at trade show exhibits, and through dealers.
Labs and studios which provide duplication and production services	Universities, community colleges and public broadcast stations which bid on these services.
Companies which serve the communications needs of the religious market	Nonprofits which sell video and audio-visual equipment and perform conference and convention duplication services.

We are united in our belief that you are making an important contribution toward the solution of the problem. We share your view that this is a "sensitive area of our tax law."

Prior to being represented before your Subcommittee by Jerry Brong of Pullman, Washington in 1987, we tried to resolve our problems through dialogue with the various organizations representing the nonprofit competitors listed above. Beginning in 1982, we also urged the Internal Revenue Service to apply current law to nearly 100 specific examples we provided them. But neither approach worked. The representatives of the nonprofits were polite but ineffective in getting results. As far as we can determine, the IRS has failed to successfully apply current law to a single example we have submitted to them.

In 1982, when we began to work intensely for solutions, the universities were not in the computer business. Today, they are. In 1982, universities were not in the videotape catalogue sales business. Today, they are. In 1982, public television stations were not a major factor in the studio-production contract business. Today, they are.

The problem has grown worse for our industry. There are almost no signs that our complaints and our offers to work out guidelines have produced results. Instead of seeing a decline in unfair competition, we see an increase. Instead of seeing fewer new entries into businesses already served by our members, we see more. That is why we feel impelled to appeal to your Subcommittee for a permanent solution.

Repeal "substantially related" test and replace it with a "directly related" test

We support this option and urge that it become the cornerstone of the solution your Subcommittee builds.

A few weeks ago, we complained to the University of Illinois about their direct-mail catalog in which they sell, via an 800 number, hundreds of popular videotapes, including the Jane Fonda workout tapes and Jane Powell's Fight Back With Fitness tapes. Purchases may be made by individuals with Visa, MasterCard, or American Express credit cards. Almost all of the tapes they offer are available commercially in video stores throughout the United States. But, when we discussed this, they maintained that the activity is as substantially related to the University's mission as several other businesses the University is engaged in.

Their video sales program has been underway for two years and present law has not worked to discourage them from the program, nor (as far as we have been able to determine) has the IRS taken the time to look at it.

With universities, most business ventures they engage in have an "educational" aspect. The word "substantial" is not enough to discourage these activities or to bring these activities in under the Unrelated Business Income Tax.

In contrast, the words "directly related" would clarify many circumstances. For example, while there is an "educational" aspect to Jane Fonda's and Jane Powell's exercise tapes, since they are not students, nor teachers, nor administrators at the University of Illinois, and since they did not make their tapes specifically for the students of the University of Illinois, there would be no direct relationship between Jane Fonda, Jane Powell and the University. Consequently, if the Subcommittee's option were adopted, should the University of Illinois select to continue to sell Jane Fonda and Jane Powell exercise tapes they would do so under the coverage of UBIT. This would be fair, equitable, and not burdensome to the educational program of the University.

The Subcommittee's option would not stop the sales, but simply tax the net income. The price of the tape might rise from $24.95 to $25.95, a price increase which would have no direct impact on education at the University.

Determine whether each income-producing activity standing alone is tax exempt

Ultimately, any solution proposed by the Subcommittee will result in a case-by-case evaluation. That is what we want the nonprofits to do: To look at every one of their business ventures and determine if it is competitive with products or services offered by the private marketplace.

What is needed is a test of commerciality. If the activity, standing alone, is a true commercial activity -- matches in most respects the commercial activity of one or more for-profit firms, then UBIT would automatically apply. This would draw the line between the commercial and non-commercial activities and eliminate much of the doubt and confusion existing in this field of tax law today.

The fact that the profits from a commercial venture are used for exemplary educational purposes should not be a determining factor. The nonprofit business venture should pay the same taxes and enjoy the same deductions as a business, including any deduction resulting from making a charitable contribution to the sponsoring university.

. . . impose UBIT on specified activities whose nature and scope are inherently commercial, rather than charitable

Apply UBIT to gift shop/bookstore income (with exceptions for (1) on-premise sales of low-cost mementos, (2) on-premise sales of an educational nature which relate to the organization visited, (3) in the case of a hospital, articles generally used by or for in-patients, (4) in the case of a university, articles in furtherance of educational programs, or low-cost items (dollar cap) and computer sales not in excess of one sale per student/faculty per year). . .

We support the option which specifically spells out in the Code the fact that UBIT applies to university sales of computers, computer software, and computer accessories.

Making this very clear in the law would eliminate the grey area that has led universities and community colleges into believing that selling computers, software, and accessories is clearly a "related" function and is not currently subject to UBIT.

According to the National Association of College Stores, 4-year universities sold $83,909,487 worth of computer hardware last year (based on a 1986-87 survey titled "Merchandizing/Operating Survey"). Other than textbooks, computer hardware was their number one best seller. Number five was computer software ($10,019,319) and number seven was electronic/computers ($7,320,038). Two-year colleges sold an additional $1,766,893 worth of these products. These figures are just for those stores which took part in the survey. Not all stores participated. We feel these figures under report the extent to which universities are involved in the sale of computers.

If they want computer sales to be located on campus, universities could contract out their sales facilities to for-profit companies. Some already do this. We do not feel that the nonprofit campus stores should be justified on the basis of "convenience." Any firm could be "convenient" if provided an opportunity to rent, or contract for, business space on the campus.

With respect to the "one sale per student/faculty per year," this would enable a university with 20,000 students to sell over 20,000 microcomputers per year without subjecting itself to UBIT. This would mean that 20,000 units per year would by law be shielded from UBIT, allowing the university $26,000,000 in tax-free income per year.

Rather than impose a tax responsibility on these university business ventures, this Subcommittee option would encourage increased sales, lead to more aggressive marketing by universities trying to make their per-student tax free quota each year, and would give an increased competitive advantage to the university store -- quite the opposite effect that the Subcommittee option is intended to achieve.

Instead, we propose that all university and community college sales of computers, computer software, and accessories be subject to UBIT. We are opposed to a per-student threshold. We are opposed to the government subsidizing though tax-exemptions the sale of a product that is readily available in every community and that is accessible to every American through commercial sales firms.

Are computers just like textbooks and thus should the sale of them be treated equally? There are for-profit stores which offer textbook sales in competition with books being sold by campus book stores. There are far more for-profit computer stores which offer computer products in competition with computers sold by campus book stores.

For most students, a computer is a one-time purchase. While some might purchase more than one during a four-year or six-year college career, most would not. Some students arrive at college with their own computer and thus wouldnot need to buy one while at the university. The Subcommittee option is flawed in its assumption that students might wish to buy one per year. While we are adamantly opposed to any threshold, a limit equal to 20% of the full-time student body would be more representative of the most optimistic student and faculty demand projections.

In conclusion, we feel that all university computer sales should be subject to UBIT. A clearcut solution like this would eliminate a major unfair factor in competition. This unfair factor -- exemption from taxes on net income -- can only be corrected by the Congress which established the tax law.

Apply UBIT to all catalog and mail/phone order or other "off-premise" sales . . .

We support this Subcommittee option. For many ICIA members, catalog sales are a major portion of their business. Competition from tax-exempt catalog sellers, such as the University of Illinois, mentioned above, undermines the market, and reduces the opportunities for growth.

There are nonprofits which publish and mail catalogs offering for sale the same equipment and supplies offered by ICIA members. The only difference is the tax treatment of the net income, and the fact that the nonprofit uses low-cost nonprofit mailing rates.

The Subcommittee option is a definite step in the right direction and should be adopted. In doing so, you will concur with a finding of the Postal Rate Commission which has recommended to Congress that nonprofit rates not apply to the catalog sales programs of tax-exempt organizations.

Repeal "convenience" exception

We support this Subcommittee option. As mentioned above with respect to the sale of computers on campus, the "convenience" of the students could be met by allowing a tax-paying firm to offer the equipment for sale in a facility leased to it by the university.

For example, some universities contract out their campus food services. The "convenience" needs of the students are still met, but the net income is subject to tax rather than shielded from tax. Likewise, university computer sales could be made by for-profit companies from a site on campus and thus would be just as convenient as the food service offered by the for-profit contractor who runs the cafeteria.

Repeal "regularly carried on" test

We support this Subcommittee option. In the case of multi-county cooperatives which perform repair services (in competition with services offered by tax-paying ICIA members), most of the service is performed once a year: between mid-June and mid-August.

Thus, their activity is not "regularly carried on" and it could be argued under the present law that their activity is a one-time service and therefore not subject to UBIT.

In fact, that same mid-June to mid-August period is exactly when for-profit companies do most of their annual repairs and maintenance of video, computer, and audio-visual equipment for schools.

To be tax exempt for their mid-June to mid-August work gives the nonprofit multi-county cooperative an unfair competition advantage over the for-profit company which is dependent on the same market opportunity.

Therefore, the "regularly carried on" test should be repealed. Instead, the test should be: Is this business activity being carried on in the same way, and during the same time, that a for-profit company is providing competition? In other words, if its operation is like a business, sells like a business, repairs like a business, does its work at the same time the business does, then it must be a business and should be taxed as such.

Apply UBIT to royalties

We support this Subcommittee option. Some nonprofits obtain profits in the form of royalties and thus screen their income from UBIT. A few years ago, the National Education Association set up a for-profit organization to sell computer software. The for-profit was to provide net profits to NEA in the form of royalties which was then to be placed in one of the NEA's charitable funds. Since the company was operating on a license from the NEA to use the NEA endorsement, the company had the NEA "halo", direct access to NEA members, and from our perspective was operating as an arm of NEA.

Under these circumstances, we felt that NEA's royalty income should have been exposed to UBIT. But, it wasn't. In this case, the NEA got into the computer software business but avoided UBIT. It was a device spawned by the royalty exemption in UBIT. The Subcommittee's option, which we support, would eliminate this loophole.

Expand Form 990-T . . . Provide more detailed reporting of revenue-producing activities and income on Form 990 . . . Require affiliated group that includes an exempt organization to file a consolidated information return . . . Recommend that IRS have an integrated examination program for exempt organizations and subsidiaries (taxable and exempt) . . . Recommend that IRS conduct . . . studies. . .

We support this entire section. We feel that the data available today from IRS is inadequate and that is because the 990 and 990T forms are (1) not producing the proper information, and (2) are not being recorded by IRS in a way useful to the Congress.

However, the form re-write and "study" approach are not alone and by themselves the solution to the entire problem. We have not come to the Subcommittee with a single new macaroni factory being operated by a nonprofit, but we have collected hundreds of examples of similar instances which, when aggregated, represent much more of a threat to the integrity of the tax law than a single macaroni factory. While no one is in a position to say how many millions of untaxed dollars are being lost by small businesses to nonprofit competitors, we know the amount is very substantial. We feel that the intensity with which the nonprofits have petitioned this Subcommittee is evidence that they are involved in far more business ventures and sales activities than the American public is aware.

Apply UBIT to . . . certain trade shows . . . UBIT would apply to income of a business association for sponsoring, endorsing, and providing the support services of an international commercial trade show.

Reviewing the three volumes of hearings on this subject of UBIT, we do not find support for this Subcommittee option.

In that the companies which exhibit at trade shows are responsible for paying taxes on the business they generate at these shows, or sales they eventually enjoy because of the exposure they obtain at these shows, we question the desirability of applying UBIT to each company's cost of renting exhibit space.

Because Congress has dealt with this issue in recent years, in particular through the amendments of 1976 and 1984, we are not convinced that a problem has arisen that is substantial enough to justify repealing the recent decisions of Congress.

In contrast, the business ventures which result in competition for the members of ICIA have grown over a 20 year period during which the law has remained unchanged while the problems have grown to be exceptionally serious. Has the trade show situation grown worse and are there incidences of abuse under the 1976 and 1984 amendments?

Whereas in the case of trade shows, there generally is no for-profit competitor to a show sponsored by a 501(c)(3) or (6) organization, there generally is plenty of competition for all the products and services sold by nonprofits in the communications industries field.

We note that some nonprofit organizations which sponsor trade shows and conventions have chosen to do so as for-profit entities. Under present law, each organization has the choice to do that, including the option of forming a for-profit subsidiary. These options should be encouraged but not mandated.

In conclusion, we commend the Subcommittee for its work in this area and we look forward to appearing before you as you entertain public debate on the options.

Sincerely,

Kenton

Kenton Pattie
Senior Staff Vice President

KP/tlh

IRSA

132 Brookline Avenue • Boston, Massachusetts 02215 • 617 / 236-1500

April 14, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Pickle:

On behalf of the International Racquet Sports Association (IRSA), a national trade association representing 1,400 taxpaying athletic fitness and racquet centers, I am writing in response to your March 31, 1988 Press Release that invited public comments on "discussion items" regarding reform of the unrelated business income tax (UBIT) regulations.

You and your colleagues on the Subcommittee on Oversight are to be commended, both for the five days of hearings you conducted in June 1987 regarding all facets of the unfair competition issue, and for the comprehensive set of discussion options for UBIT reform that you have developed.

The fact that most YMCAs throughout the country have adopted in recent times a commercial, competitive operation stance in the recreation and fitness field has been well documented in the transcript of the June 1987 hearings and by written submissions for the record. The commercial nature of YMCA operations has also been dramatically noted by State and County tax assessors (such as those in Portland, Oregon; Moline and Rock Island, Illinois, Olympia and Tacoma, Washington; Topeka, Kansas; and most recently, Pittsburgh, Pennsylvania), where all or part of the facilities have been ordered returned to the property tax rolls (leading to current and past tax liabilities ranging from $430,000 to $1.2 million), and State tax exemptions revoked.

Simply put, it is a question of how the issue is phrased. If the question is posed as "why are you performing this activity?" it gives rise to a broad response of noble purposes (e.g., contributing to the mental, physical and spiritual well-being of people) which is a universal mission. However, if the question is phrased "what are you doing?" a much different response results -- providing a service or product for a fee (in direct commercial competition with other tax-paying, small business providers). In other words, what the Ys and (and JCCs and tax-exempt hospitals) are doing is a business with all that this encompasses -- marketing plans, advertising, initial extra benefits, fee scales, and ultimately profits, which, because of their tax-exempt status are put back into staff salaries and benefits, facilities improvements, capital commercial expansion, and also, subsidies to other programs. However, long ago, Congress put to rest the "destination of income" test as a basis for exempting net revenues from taxation.

Thus, in direct response to your Press Release, IRSA would prefer to see the repeal of the admittedly unworkable,

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arbitrary and nebulous "substantially related test," and we similarly would not favor the adoption of a "directly related test" and question the workability of an income-producing activity by activity determination of tax-exemptions.

Rather, we support your limited commerciality test approach whereby UBIT would be imposed on activities whose nature and scope are inherently commercial, rather than charitable, and submit that the health, recreational, fitness and exercise activities of the Ys (and similar tax-exempt organizations) clearly would be recognized by reasonable people as included in that inherently commercial category.

While we agree with your "discussion option C" that the "income from certain health, fitness, exercise and similar activities" be subjected to UBIT, we strongly and respectfully oppose the exclusion clause about community affordability, since even such organizations as Independent Sector have acknowledged that this maintains the status-quo (in which, we contend, and local and State tax assessors have agreed, that massive unfair competition has taken place and continues to take place).

Rather than enter into further potential problem-creating requirements dealing with area poverty and wage levels, or ratios of service availability, IRSA would like to propose the following recommendation:

> Apply UBIT to income from certain recreational (or health), fitness, exercise and similar activities, except for fees received from the so-called charitable classes, i.e., unemployed, low-income senior citizens, military and underprivileged youth.

The "charitable class" category has a clear IRS traditional meaning (CF. GCM 35-601).

IRSA also would support repeal of both the "convenience" and "regularly carried on" exceptions because income from activities that are not a trade or business should remain tax-free.

Under "IV" (Tax Treatment of Royalty Income), IRSA would caution that an exception for products that are part of the organization's exempt function could lead to abuses, such as the sale of athletic equipment, shoes, clothing with official logos, etc., as a lucrative type of partnership or mutual business venture which has nothing to do with the organization's stated mission, and is only another aspect of competitive trade or commerce.

IRSA also would recommend that the following language be added:

> Whenever a tax-exempt organization solicits or receives donations, contributions, etc., it must specify that none of the funds will be used for unrelated business activity and the donors should be so informed in writing. Should there be any violation of this, all sums should be returned to the donor immediately, with adjustments for tax penalties to make the donor whole.

This would ensure that the use of current reserves or investment principal and interest, resulting from past or current charitable contributions or donations, could not be used to fund additional, non-exempt, anticompetitive business ventures, e.g., the construction of new, upgrade, athletic clubs in downtown business or affluent suburban areas.

To assure, under "VIII" (Allocation Rules), that a reasonable model be considered for proper cost allocation, with a long trackrecord of use in Federal reporting under the Medicare program, IRSA recommends the following addition:

> Similar cost-funding requirements as exhibited on Medicare Form HCFA-2552-85 ("Adjustment to Expenses") should be used to allocate allowable expenses to offset commercial activity revenues.

In this way, the income subject to UBIT would be fairly established.

Under "IX" (Tax Information Reporting/IRS Administration), IRSA strongly recommends that the following additional reporting requirement be added for the Form 990-T:

> (3) All revenues associated with support for non-exempt, commercial activity, including gifts, donations and investment income, should be disclosed, thus subscribing to the accounting principle of matching actual revenues to actual costs.

Finally, IRSA strongly urges the Subcommittee to adopt the recommendation of the Small Business Administration (SBA) that the IRS institute an expedited, administrative channel for the filing and review of complaints relating to the commercial activities of tax-exempt organizations. The protective spirit of UBIT and administrative efficiency of the IRS can be better served if the IRS has access to information targeting potential noncompliance with the law. Tax-paying small businesses are in the best position to identify potential violations of the law, but currently have no formal mechanism to do so.

Mr. Chairman, we commend you and your colleagues for your efforts to arrive at a just and equitable solution to the manifold problems associated with the unfair competition experienced by tax-paying small businesses from the tax-exempt sector. We applaud your efforts to restore and preserve the original intent of the UBIT legislation, and look forward to working with you.

Respectfully,

John McCarthy

John McCarthy
Executive Director

COMMENTS
OF
GENE R. STALIANS

PRESIDENT
OF THE
INTERNATIONAL TAXICAB ASSOCIATION

TO THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

CONCERNING

DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

April 15, 1988

The International Taxicab Association (ITA) representing over 600 taxicab and paratransit companies located in every major metropolitan area in the United States, as well as in many rural counties and municipalities, supports the efforts of the Subcommittee on Oversight to address many of the problems inherent in the current structure of the unrelated business income tax. ITA was pleased to testify before the Subcommittee last year in support of proposals to tax the unrelated business income of exempt organizations that unfairly compete with taxable taxicab and paratransit service providers, and we look forward to the successful conclusion of its work.

However, while the discussion options address many of the abuses of tax-exempt status cited in the hearings, they do not adequately address the unfair competition from exempt organizations faced by taxicab and paratransit companies. ("Paratransit" companies provide a range of public transportation services, including taxicabs, livery, vans, and mini-buses. These services may be scheduled or "on-call," and are often targeted to the elderly and handicapped, using specially modified equipment.)

ITA agrees that travel and tour services provided by all nonprofit organizations (not only colleges and universities) should be subject to unrelated business income tax. ITA also supports the extension of this principle to all transportation services provided by tax-exempt organizations, except when the services are provided for less than cost (taking into account government contracts, grants, and subsidies, as well as charges to the passengers) to a charitable class of recipients. Many exempt organizations are engaged in providing "common carrier" service to the general public using automobiles and vans, either for a fee or using subsidies from Federal, state, and local governments. These services directly compete with taxable taxicab and paratransit companies, and should be subject to unrelated business income tax.

ITA also supports the repeal of the convenience exception to the definition of an unrelated trade or business. This exception has enabled many charitable organizations, such as retirement and convalescent homes, to launch transportation services for their residents and patients that then become a springboard into "triple dipping" - - providing service to the general public (1) under government contracts or grants, (2) often using Federally subsidized equipment, (3) at the expense of otherwise taxpaying entrepreneurial businesses.

For example, in LaCrosse, Wisconsin, Topp's Taxis and the LaCrosse Cab Company, both operated by Top Hat Partners, have faced unfair competition from Bethany Lutheran Homes, a tax-exempt nursing and retirement home that has used Federal and state grants to expand its transportation services, originally provided only to its residents, to non-resident elderly and handicapped persons. Because of its tax-exempt status, Bethany Lutheran Homes has been able to obtain county contracts to provide these services even though Top Hat Partners has consistently offered to provide more hours of service for less money. Early in 1987, Bethany Lutheran Homes withdrew a request for state grant, funded by the Urban Mass Transportation Administration (UMTA), to purchase vans, after the Wisconsin Department of Transportation indicated that Bethany would be required to subcontract operation of the vans to Top Hat Partners, due to Top Hat's documented lower costs. This protection of the private sector is, unfortunately, unusual; however, we believe the Federal government should be as vigilant as the Wisconsin Department of Transportation.

For this reason, ITA also supports the discussion option to disallow deductions from gross unrelated business income for general overhead and depreciation on assets used in performing exempt activities. Because these costs would be incurred regardless of the existence of the unrelated activity; they should not be deductible in determining unrelated business taxable income.

Conclusion

ITA thanks the Subcommittee for the opportunity to present its views on these important issues. Should you or your staff have any questions about our comments, please do not hesitate to contact our Executive Vice President, Mr. Alfred B. LaGasse III, at 3849 Farragut Avenue, Kensington, Maryland 20852, (301) 946-5700.

IROQUOIS COUNTY HISTORICAL MUSEUM
OLD COURT HOUSE — WATSEKA, ILLINOIS 60970

April 12, 1988

To the members of the Ways and Means Committee:

Our organization is a 501c3 exempt organization, which, for a variety of reasons, is the recipient of only minimal governmental funding, and then almost entirely as payment for services. Our revenues, which support a museum building built in 1866, pay staff salaries, and enable us to operate the cultural hub of this rural Illinois county, are earned from memberships, donations, and the sales of merchandise. Much of this merchandise is Museum related, such as histories, trinkets bearing our logotype, and so on, but much is not so clearly related. Many of our sales are of items donated by our members, such as plants, potholders, decorated eggs, and crafts. From these sales, of course, are our bills paid.

The Iroquois County Historical Society does not operate a grocery store, service automobiles, build new homes, nor do we intend to engage in outside commercial activities. But our in-house sales serve as a valuable and probably irreplaceable source of funds for our insitution.

Were we to lose our ability to unrestrictedly sell unrelated items, such as the crafts mentioned above, our only immediate source of new funding would be some form of governmental subsidy. We are working hard to develop new ways to raise revenue. We have expanded our schedule of events, joined a tourism association, and encouraged associated organizations to put more of their money into our operational budget. We have attempted to cut costs, and indeed operate this former courthouse for less money than the utilities alone for the new one. The loss of a percentage of the gross sales by having it declared taxable income would be a sudden and harmful blow to the financial health of this and many other small, not for profit, organizations, who have to scrape the money together each year to meet expenditures. The revenues raised by a change in the Internal Revenue Code would hardly outweigh the cost to small institutions such as ours, and, worse, may cause an increase in the amounts needed as subsidies from all levels of government.

I appreciate the consideration given to my statement and hope that the committee will take into account the problems of small organizatins in making its decision about the exemption of substantially related merchandise sales from taxation.

Sincerely,

Alan L. Benjamin

Alan L. Benjamin, President
Iroquois County Historical Society

Clifton O. Istre Jr., Ph.D.
1472 So. College Rd. #102
Lafayette, LA 70503
(318) 233-4081
1-800-344-9758

April 13, 1988

TO: Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

re: Commerical Hearing Aid Sales and Non Profit Organizations.

Dear Mr. Leonard:

At one time I was employed in a University setting, but now am in private practice which includes hearing aid sales. It is the small businessman which helped make America. He took the risks and made the ventures. Some were successful and others failed.

There are risks in doing what I do. I consider it economically obscene to have to compete with nonprofit educational institutions and organizations in the sale and service of hearing devices for the hearing impaired. While such organizations are able to reap the cream by often providing sales only, individuals such as myself often must do the servicing.

For profit any businessman will say that the key for success is to keep overhead low. Nonprofit organizations have little to no overhead. Many have salaried employees who can vendor a hearing aid for any price they wish. It just has to be above cost. There is no way we can compete with that arrangement.

Educational institutions exists on taxpayers monies. Why should a businessman pay taxes to support a institution which will in turn be his competition? It just does not make sense.

Your committee has an excellent package of reform measures. My request is that you will include the problem with hearing aid sales by nonprofit organizations.

Sincerely,

Clifton Istre Jr. Ph.D

Clifton O. Istre, Jr. Ph.D. CCC A/Sp

COMMENTS ON
UNRELATED BUSINESS INCOME TAX DISCUSSION OPTIONS
SUBMITTED TO THE SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS

April 15, 1988

We appreciate this opportunity to respond to the request made by the Subcommittee in its press release of March 31, 1988, for public comments on the Discussion Options relating to the unrelated business income tax ("UBIT").

We wish to comment on an issue raised in Discussion Option IV regarding the tax treatment of royalty income. Our specific concern is the appropriate treatment of mineral royalties.

As a general matter, we appreciate the difficulty involved in any attempt to differentiate among types of passive income for purposes of determining which income should be excluded from the UBIT. Option IV suggests two instances in which it may be appropriate to subject royalties to UBIT -- first, where royalties are measured by net or taxable income derived from the property; and second, where an organization receives royalties on property it either created or incurred substantial costs in developing. An exception would be provided for products "that are part of the organization's exempt function." Moreover, neither rule would subject "certain non-working property interests" to UBIT.

Option IV would retain present law for mineral royalties. We think this is clearly the correct result because, as discussed more fully below, the potential UBIT problems presented by certain royalties do not exist in the case of mineral royalties.

Both areas of concern suggested in Option IV apparently stem from the notion that certain royalties more closely reflect involvement or participation in a business-type endeavor than they do mere passive investment. Subcommittee staff have suggested examples in which the use of an exempt organization's name, products, or logo in a trade or business is tantamount to a business activity on the part of the organization.

Option IV recognizes that neither suggested approach would be appropriate to apply to mineral royalties, which by their nature are passive investments. By definition, the owner of a mineral royalty, whether measured by production or by gross or taxable income, is neither directly or indirectly engaged in the trade or business of mineral development and production. Mineral royalties, under both state law and general federal income tax principles, are non-operating, passive, non-business interests in mineral properties. For these reasons, mineral royalties have been expressly excluded from the definition of unrelated business taxable income since the inception of this provision.

The Nature of a Mineral Royalty

A mineral royalty is a right to the minerals in place that entitles its owner to a specified share of the total production from the property, free of development and operating expenses. In a typical transaction, the owner of an interest in minerals conveys the so-called working or operating rights in the minerals to a lessee, retaining a landowner's royalty. This retained royalty interest is the mineral interest stripped of the burdens and rights of developing the property, while the working or operating interest granted to the lessee is an interest in the minerals in place which is burdened with the costs of exploring, developing and operating the property.

The term "royalties" includes not only landowners' royalties, but also overriding royalties. An overriding royalty is a separate royalty interest that is carved out of the working interest and is co-extensive with the life of the working interest from which it was created.

As in the case of a landowner's royalty, the owner of an overriding royalty is entitled to a specified fraction of the total mineral production from the mineral property, free of development and operating expenses. The owner of an overriding royalty has no control, right, or power over the exploration, development or operation of the mineral property, nor is the owner subject to any liabilities associated with such exploitation of the property.

An overriding royalty will be payable solely out of the gross mineral production of the property. It may be measured by a fixed percentage of gross production (or proceeds) from the mineral property, like the typical landowner's royalty, or by the net profits from the operation of the burdened working interest. This type of overriding royalty is often referred to as a "net profits interest."

For all federal income tax purposes, neither the courts nor the Internal Revenue Service draw any distinction between an overriding royalty measured by a fixed percentage of production and an overriding royalty measured by the net profits from the burdened property. A "net profits interest" is simply treated as any other mineral royalty, that is, as a non-operating depletable "economic interest" in the minerals in place.

Mineral Royalties Are Inherently Passive

Overriding royalty interests, whether measured by a fixed or variable percentage of the gross production from the burdened mineral property, are property interests separate from the interests held by the owners of the working or operating interest. The owners of a working interest engage in the trade or business of mineral development and production. The owner of an overriding royalty interest, on the other hand, holds a non-operating interest and does not have the right under state law to conduct any enterprise, i.e., to carry on any trade or business, with respect to the mineral property. No joint activity exists between the owner of the operating interest and the royalty owner. Accordingly, the relationship between the holder of an overriding royalty interest and the owner of the working or operating interest is not classified as a partnership for either state law or federal income tax purposes.

For state law purposes, the holder of a royalty interest has a separately identifiable real property interest. As a result, the status of the owner of the working interest does not affect the rights of the royalty owner. Thus, the transfer of the working interest or the bankruptcy of the holder of the working interest will not extinguish the rights of the royalty owner.

The creation of an overriding royalty interest for tax purposes is treated as the sale of an interest in the mineral property. In the non-mineral context, the creation of a net profits interest in a venture generally is treated as a contribution to a partnership. Moreover, the owner of a working or operating interest in a mineral property burdened by an overriding royalty treats the income to be attributed to the overriding royalty interest quite differently for tax purposes than does the owner of a non-mineral business subject to some form of net profits interest. In the mineral context, the income attributable to the net profits interest flows directly to the owner of that interest (because it is a separate economic interest) and not to the owner of the working interest from which it was created. In the non-mineral case, however, the owner of the business must include the entire income from the endeavor in income, and may take a deduction for the royalties paid to the owner of the net profits interest.

Conclusion

By definition, then, the owner of a mineral royalty interest, whether that interest is measured by a fixed or variable percentage of gross production, is not in a trade or business for federal income tax purposes. The concerns which underlie the proposed treatment of royalties for UBIT purposes under Option IV do not exist in the case of mineral royalties.

Option IV properly recognizes that narrowing the exclusion under section 512(b)(2) to subject to UBIT all royalties measured by net profits, without retaining current law for all mineral royalties, would be inconsistent with the nature and purpose of the unrelated business income tax and the longstanding tax treatment of mineral overriding royalties measured by net profits.

* * *

These comments are submitted on behalf of J.P. Morgan Investment Management, Inc. by John E. Chapoton, L. Price Manford, and Christine L. Vaughn, of Vinson & Elkins, 1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004, telephone no. (202) 639-6500.

Jamiesnon Hearing Aid
13076 Northline
Southgate, MI 48195

Robert Leonard
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House office Bldg.
Washington, D.C. 20515

Dear Sir,

As a for profit hearing aid dealer I have found it exceedingly difficult to maintain indifference to the local school districts, hospitals and universities who dispense hearing aid s as a non-profit.

My tax dollars support them yet they are in direct competition and at an unfair advantage to me.

I urge you to reform the UBIT that presently applies to nonprofits and make these measure more realistic and in step with for profit business upon which this country was built.

Also please repeal the existing convenience exemption for patients or recognize patients as inpatients only.

Thankyou for your consideration to this matter,

Philip G. Jamieson

JOSLYN
ART MUSEUM

April 15, 1988

Mr. Robert J. Leonard, Chief Counsel
Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

Enclosed please find our response to the Subcommittee's request for public comments on discussion options relating to the unrelated business income tax.

After reviewing our comments, we believe that you will be able to see what a vast impact these comtemplated changes will have not only on the financial aspect, but on the whole mission of our institution as well.

We might add that these changes come on top of the IRS elimination of charitable deductions for non-itemizers. The anticipated losses of contributions to non-profits from this new tax legislation will make a huge impact on our operations. Do not support the proposed UBIT changes and urge their defeat.

Sincerely,

Henry Flood Robert, Jr.
Director

cc: Hal Daub, U.S. House of Representatives
American Arts Alliance

lh/enclosure

2200 DODGE STREET
OMAHA, NEBRASKA 68102
(402) 342-3300

DISCUSSION OPTIONS

I. **"Substantially Related" Test:**

Retain "substantially related" test; however, impose UBIT on specified activities whose nature and scope are inherently commercial, rather than charitable.

A. Apply UBIT to gift shop/bookstore income (with exceptions for (1) on-premise sales of low-cost mementos, (2) on-premise sales of an educational nature which relate to the organization visited.

Comment: At the present time our Museum Shop includes general art history books and other general museum/art items not directly related to our collection. We are not in a major metropolitan area and our own collections are not of the size or quality of major world museums. We would love to be able to provide our members with publications related to a vast collection under our jurisdiction; however, since this is not the case, we feel that providing them with art history books helps extend the educational experience they have received from a visit to our institution. To make these general books and reproductions fall under UBIT would be discriminatory toward smaller institutions.

A. In addition, apply UBIT to income from all catalog and mail/phone order or other "off-premise" sales (with exception for de minimis sales, in relation to amount of "on-premise" sales).

Comment: Joslyn Art Museum's off-premise sales involve only Joslyn collection and exhibition related items, and **this practice is undoub**tedl**y typical** of museum shops **generally.**

IV. **Tax Treatment of Royalty Income:**

Apply UBIT to royalties measured by **net or taxable** income derived from the property; or royalties received by an organization for use of property if such organization, or closely related organization, etiher: (1) created such property, or (2) performed substantial services or incurred substantial costs with respect to the development or marketing of such property. Retain present law for certain non-working property interest, and exception for products that are part of the organization's exempt function.

Comment: Although this is not an area in which the Joslyn is currently active, we cannot imagine going into some sort of project that would not relate to the Museum's collections and exhibitions and therefore to our exempt purpose.

VIII. Allocation Rules:

With respect to facilities used for exempt purposes as well as unrelated business purposes, allow a deduction against UBI for a proportionate share of the direct operating cost of the facility (e.g., maintenance, insurance, and utilities), but not allow a deduction for a share of the general overhead of the organization or for depreciation.

Comment: Part of our facility is allocated to unrelated business purposes. There are certain general administrative expenses (example: annual audit fee) that cover both our related and unrelated areas of activity that cannot be directly allocated to a specific activity. It would be unfair to not allow a deduction for a share of general overhead to unrelated activity. The same argument would apply to depreciation. The unrelated business activity uses part of the facility that is depreciating. Is it fair for this activity to use general administrative services and part of the building and not charge them the costs? If the purpose here is to make non-profits be competitve with for-profits, then we, the non-profit, should be allowed the same deductions. Or will for-profits a general overhead and depreciation deduction either? There should be consistency.

IX. Tax Information Reporting/Internal Revenue Service (IRS) Administration:

Expand Form 990-T reporting requirement to include more reporting on: (1) activities and income which the organization claims to be exempt or excluded from UBIT, and (2) revenue sources such as contributions, grants or other funding sources.

Comment: This information is now being reported on Form 990. Asking for this information on the Form 990-T, would be duplicating reporting requirements, thereby adding to our administrative work load.

Require affiliated group that includes an exempt organization to file a consolidated information return.

Comment: The women's groups now associated with our organization provide untold volunteer services compared to the relatively small amount of revenue produced. We feel that this would not be worth the time expended to monitor the activity for the benefit received.

Recommend that IRS have an integrated examination program for exempt organizations and subsidiaries (taxable and exempt).

Comment: It is unclear what is meant by this statement.

April 13, 1988

The Honorable J. J. Pickle
242 Cannon House Office Building
Washington, D.C. 20515

Subject: Press Release #16
New Proposal Regarding UBIT
Unrelated Business Income Tax

Dear Mr. Pickle,

On Behalf of the Junior League of Tyler, Inc., we are compelled to respond to the Press Release #16 concerning the Committee on Ways and Mean's new proposal regarding the unrelated business income tax(UBIT)! We are adamently opposed to this new proposal. Every dollar of the funds raised by the Junior League of Tyler, Inc. is returned to the community through our placements and projects. Over the past five(5) years, the League returned approximately $424,500.00 and 156,000 volunteer hours. Many of our projects and placements have come into being to fill voids left by Federal and State funding cuts. Indeed, we are filling many desperate needs in our community. The new proposal is tantamount to a death sentence to many of these services. The Junior League of Tyler, Inc. cannot and will not stand in silence while attempts are made to drain the life force from our organization.

We and the thousands of people who benefit from our work would be grateful for your consideration and efforts in opposing this matter.

Sincerely,

Shane Voight
Shane Voight
Chairman, Public Affairs

Marilyn Hardy
Marilyn Hardy
President, Junior League of Tyler, Inc.

5201 S. BROADWAY SUITE 2710 • TYLER, TEXAS 75703

STATEMENT OF KAISER FOUNDATION HEALTH PLAN, INC. REGARDING OUTPATIENT PRESCRIPTION DRUG REVENUES

Press Release #16 of the Subcommittee on Oversight of the Committee on Ways and Means states that the Subcommittee's discussion options include repeal of the "convenience" exception, but that:

> "Income from activities that are substantially related to the organization's exempt purpose would remain tax free, subject to the specific rules listed in Section I. above."

Section I discusses application of the unrelated business income tax rules to sales of "...pharmaceutical drugs and goods (with exceptions for (1) inpatients, continuous-care outpatients, or emergency treatment outpatients...."

Possible repeal of the "convenience" exception (and resulting implications for revenue from drug sales) is directed to sales by hospitals. However, if not carefully drafted, any change relating to revenues from drug sales could inadvertently extend the unrelated business income concept to outpatient drugs provided by health maintenance organizations (HMOs) to their enrolled members as part of their covered benefits.

Background

The Kaiser Permanente Medical Care Program ("Program") is a health care delivery system that organizes and provides comprehensive prepaid health care services to more than 5 million voluntarily enrolled members in 12 regions of the country. Kaiser Foundation Health Plans ("Health Plans"), Kaiser Foundation Hospitals ("Hospitals") and the Permanente Medical Groups ("Medical Groups") comprise the Program. Health Plans and Hospitals are 501(c)(3) organizations; each Medical Group is organized as a professional corporation or partnership.

Health Plans are federally qualified HMOs that enter into membership contracts with groups and individuals and arrange comprehensive, predominantly prepaid health care services for their members. Health Plans contract with Hospitals to provide or arrange necessary hospital services and facilities, and with

Medical Groups to provide or arrange for professional care for their members.

All members receive outpatient prescription drugs at Program pharmacies operated by Health Plans and Hospitals at special member rates that are lower than rates for non-members. More than two-thirds of Health Plan members enroll on an optional basis in supplemental prepaid outpatient prescription drug programs under which covered members receive drugs at a sharply reduced charge or without any additional charge. Thus, all members, through full or partial prepayment, are entitled to outpatient prescription drugs at Program pharmacies as part of their Health Plan benefits.1/ Because all or a substantial portion of the charge is prepaid, the point-of-service revenue (if any) is not comparable to the fee-for-service charge by a community pharmacy for the same prescription. Sales to non-members through Program pharmacies represent less than one-fifth of one percent of community non-member sales. Revenues from non-member sales through Health Plan pharmacies are reported as unrelated business taxable income.

Provision of outpatient drugs to members through Program pharmacies operated by Health Plans and Hospitals is related to Health Plans' exempt purpose to provide comprehensive health care, and does not give rise to unrelated business taxable income, as the IRS has recognized. This result is based on Health Plans' exempt purpose, and is unrelated to the "convenience" exception.

Request

If the "convenience" exception is modified or repealed, it should be clear that this change does not alter the status of prescription drug revenue from Health Plan members. This revenue is derived from performance of an exempt purpose to organize and provide comprehensive health care.

1/ Some Health Plans, because of small membership, cannot economically operate their own pharmacies, and members of these Plans obtain their prescription drugs from community pharmacies.

**KATZ
HEARING AID
CENTER** 965 N ALVERNON WAY TUCSON, ARIZONA 85711 (602) 326-3131

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Unrelated Business Income Tax (UBIT)

Dear Mr. Leonard,

I would appreciate it if you would make known to Rep. Pickle and the members of the Sub Committee on Oversight how much I personally appreciate the work they have done so far on the problems of unfair competition engaged in by "not for profits". I have been involved with this problem on a local level related to the sale of hearing aids.

I have read with interest the information you have sent me regarding your hearings relating to (UBIT). The proposed reform measures are an excellent answer to a problem which has reached into every facet of American life.

Competing with businesses which have the same advantage or disadvantage is proper. But it is not proper for me to have to compete for a livelihood with the hearing aid dispensing (sales) activities of six "not for profit" hospitals plus a state university. All sales of prosthetic devices by a hospital which is not related to in-patient surgery should be taxed. The convenience exemption for patients should be repealed.

"Not for profits" should not be able to send sales brochures through the mail at one third of the cost which my government charges me. We need government to recognize the realities of how the "not for profit" have raped our tax laws.

Please help the small businesses of this country stand up to the on-slaught of the multi-billion dollar "not for profit" industry. The reform measures which you are considering will go a long way towards leveling the "playing field". I urge you to forward them as is.

Sincerely,

K. Ray Katz, B.C.-H.I.S.

KRK/zc

AFFILIATED WITH
WASHINGTON STATE HISTORICAL
SOCIETY

Kitsap County Historical Society
3343 N.W. Byron Street
Silverdale, Washington 98383
(206) 692-1949

April 11, 1988

Robt. J. Leonard, Chief Counsel
Committee on Ways and Means, U.S. House
1102 Longworth House Office Building
Washington, D.C., 20515

Dear Sir, et all

Let's acknowledge the 'bottom line' first: money makes things happen; tax structures create the money. People 'do' or 'don't do' according to the current tax laws.

With the above assumptions, we can state that MUSEUMS will exist only three ways: A) Government (various levels) subsidies; B) tax structures that make it "worthwhile" for the private (including commercial) sector to support; C) large enough entrance fees to cover all costs. Briefly, let me just say that such fees would eliminate the educational opportunities to our society at large; and after all, 'musuems' and 'education' are synonymous.

I think that you as a representative in our Government need to be fully aware that if A or B are not options, that the option C is basically canceling a basic premise of a free and intelligent society. Museums as educational institutions/and deserve the same support as public schools, public roads and public police forces.

Tax structure should either pay for or allow for the necessities of life. Please be aware of what reducing tax breaks on museum gift shops, etc. will do.

Sincerely,

Suzanne T Anest

Suzanne T. Anest, Director
Kitsap County Historical Museum

:s
copies

THE KRASL ART CENTER

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

In reference to your committee's hearings on preliminary discussion options regarding the unrelated business income tax (UBIT). We are a non-profit educational institution [501 (c)(3)] and are opposed to any changes to the present law.

During the 1980's, museum and art centers in the United States have faced serious problems raising funds to finance the growing need for educational activities. Many museums already face difficulties finding money to replace the declining revenue from state and federal sources. Being told that we must pay taxes on some of our revenue-makers could have a crippling effect on our art center's ability to provide quality programs to our community.

We urge that your committee recommend that the law remain as is.

Sincerely,

Darwin R Davis

Darwin R. Davis
Executive Director

DRD/jbp

cc: Barbara Hall, President
Patrick Kinney, Attorney

707 Lake Boulevard • St. Joseph, Michigan 49085-1398 • 616 983-0271
Accredited by the American Association of Museums

LACKAWANNA HISTORICAL SOCIETY
232 MONROE AVENUE
SCRANTON, PENNSYLVANIA 18510
TELEPHONE: (717) 344-3841

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing, as chief executive representing the Lackawanna Historical Society, located in the historic Catlin House, at 232 Monroe Avenue, Scranton, Pennsylvania 18510, in reference to the Society's views about the pending revision of rules pertaining to the taxation of non-profits' revenue-producing activities.

We feel, as a small local museum and historic house, that the proposed legislation, as written, would be damaging to museum operations and to the continued survival of small museums which generate a large portion of their operating and maintenance income from activities which would fall under taxation in the new proposed guidelines.

While we are not opposed to the idea of revisision of the taxation laws governing non-profit organizations, we strongly oppose legislation which would affect the income-producing activities of museums.

Our museum, a very small one, operates on a limited budget ($48,000) each year. If our income-producing activities become taxable, we will have to curtail some of our activities which we provide to the public and to members of the Lackawanna Historical Society. Most of our budget goes to maintain and heat the building and to keep it in repair. The second large part of the budget goes for staff salaries (to provide tour and library services to the public.) The final ¼ of the budget is used to provide public services and public programs (a monthly lecture series, library research services, a bulletin of information, and other printed matter of an historical nature.) We are PREVENTED by the terms of a bequest which gave us use of the historic Catlin House building from charging for tours of the house. We must offer tours of the museum to the public free of charge, according to the will of George Henry Catlin, who bequeathed the home to the Lackawanna Historical Society to be used as a museum and research center. Therefore, our income is generated through sales of books, membership dues, and investment in revenue-producing things such as stocks & bonds and mutual funds which produce our operating income. We feel that if the income from these activities is taxed, our operating budget will have to be curtailed, since we have no prospects of raising additional revenue to counteract the funds which might be lost through having to pay taxes.

The Lackawanna Historical Society proposes that the Ways and Means Committee consider including an addendum to the proposed revision of taxable income for non-profits to broadly exclude MUSEUMS and HISTORICAL Societies, since these organizations operate for the public benefit entirely and operate for educational purposes. If that is not possible, we suggest that only museums with an annual operating budget of over $1,000,000 or some such large sum, as smaller museums do operate on limited resources. Taxation of the revenue-producing activities of small museums will only hurt them, causing curtailment of programs and/or hours of operation.

Sincerely,

Dorothy Allen Silva

Dorothy Allen Silva,
Executive Director

·LAGUNA
GLORIA
ART POST OFFICE BOX 5568 AUSTIN, TEXAS 78763 512 458-8191
MUSEUM

April 12, 1988

The Honorable J.J. "Jake" Pickle
224 Cannon House Office Building
Washington, D.C. 20515

RE: Unrelated Business Income Tax

Dear Congressman Pickle:

I have reviewed the "discussion options" for changes to the unrelated business income tax as they relate to Laguna Gloria Art Museum. While we currently do not generate significant "unrelated business" income, the proposals raise important concerns for us when we open the new museum in downtown Austin in 1990. Of particular concern to us are:

1) Museum Gift Shop Sales - it is unclear how the exceptions for on-premise sales of "low cost" mementos and educational items will be treated. Laguna Gloria is not a collecting museum but has 20th Century American art as its focus and treats its exhibitions as its collections. While we are currently able to meet the "relatedness" test, we are concerned that the new standard not be too narrowly interpreted to count as unrelated sales by a museum without a permanent collection.

2) Travel Services - while this is not significant income to us, we are dealing with the fact that Austinites must travel to places like Dallas, Houston, New York, or Los Angeles to view important exhibitions of 20th Century American art. This is viewed primarily as a service to members, though we are concerned that our tour prices not be prohibitive due to taxation of net income.

3) Food Services - our new museum will offer a restaurant as a service to visitors. It is our understanding that the discussion options would continue to exempt museum restaurants, and we encourage you to preserve this exemption.

4) "Regularly Carried On" Exemption - if this rule is repealed, it might affect activities such as galas, benefit performances, and auctions. However, because most of our special fund-raisers (such as FIESTA) are conducted with donated labor, they would fall under that exemption. Thus if the exemption for income from activities conducted with volunteer labor is retained, we will probably not be significantly affected.

5) Facility Rentals - the museum currently generates modest income from rental of its facilities but expects to earn significantly more with a new building. While rental events vary in their relatedness to the museum's activities, we consider them an important part of our educational and membership outreach program. Docent tours of exhibitions are often offered as part of a special event rental. Frequently a rental event will be a person's first exposure to the museum experience, and we view this as an opportunity to reach new audiences. While it is difficult to clearly distinguish the educational from the social components of this income, we feel that facility rentals are unique services offered by museums which directly relate to our educational purposes. I urge you to consider this in your deliberations.

Jake, I commend you and your committee for its months of hard work and thoroughness of its approach. The UBIT issues are far-reaching and are of fundamental importance to the museum. I hope that the concerns expressed will be considered in your discussions and that the guidelines you adopt will be fair and yet not place too great a burden upon our income-generating abilities. I am confident that you will succeed.

Thank you for your attention to this matter and let me know if I can provide further information.

Sincerely,

Laurence Miller
Director, Laguna Gloria Art Museum

LM:jr

LAGUNA
GLORIA
ART MUSEUM
POST OFFICE BOX 5568
AUSTIN, TEXAS 78763
512 / 458-8191

APR 18 1988

6 APRIL 1988

THE HONORABLE J.J. PICKLE
763 FEDERAL BUILDING
AUSTIN, TEXAS 78701

CONGRESSMAN PICKLE:

FOR THE LAST TEN YEARS I HAVE BEEN INVOLVED IN THE RETAIL BUSINESS IN AUSTIN, OWNING MY OWN BUSINESS FOR EIGHT YEARS, AND NOW AS MANAGER OF THE LAGUNA GLORIA ART MUSEUM SHOP. I HAVE ALSO BEEN ACTIVE IN RAISING MONEY FOR ARTS ORGANIZATIONS. IN DECEMBER OF 1987 I ORGANIZED "OBJECTS", A SEASONAL RETAIL OPERATION WHICH MARKETED ARTS & CRAFTS BY AUSTIN ARTISTS. ALL PROCEEDS FROM THIS OPERATION WENT DIRECTLY TO THE ARTISTS INVOLVED AND TO SUPPORT AUSTIN VISUAL ARTS ASSOCIATION, AN ARTS SUPPORT ORGANIZATION FOR WHICH I AM A BOARD MEMBER.

I AM VERY CONCERNED WITH THE CHANGES BEING PROPOSED IN THE "SUBSTANTIALLY RELATED TEST" FOR EXCEPTIONS TO THE UNRELATED BUSINESS INCOME TAX. WITH THE MUSEUM STORE'S PURPOSE BEING PART EDUCATIONAL, AND PART FINANCIAL, THESE CHANGES COULD SERIOUSLY AFFECT BOTH GOALS.

EDUCATIONALLY, THESE CHANGES WOULD LIMIT OUR MERCHANDISE TO LOW-COST ITEMS THAT RELATE TO ONLY TO OUR ORGANIZATION, NOT OUR STATED PURPOSE. THIS WOULD MEAN WE COULD SELL, WITHOUT TAX, PICTURE POSTCARDS DEPICTING THE MUSEUM BUT NOT A BOOK ON 20TH CENTURY ART, LAGUNA GLORIA'S COLLECTING GOAL. THIS IS SURELY AT ODDS WITH THE EDUCATIONAL PURPOSE OF OUR MUSEUM.

ON THE FINANCIAL SIDE, AS YOU MUST REALIZE, RAISING MONEY FOR ARTS ORGANIZATIONS IS A VERY DIFFICULT PROPOSITION. WITH SOURCES FOR MONETARY SUPPORT BECOMING MORE AND MORE SCARCE, FUNDRAISING THROUGH RETAIL OPERATIONS IS CRITICALLY IMPORTANT. ALLOWING MUSEUMS MORE LATITUDE IN RAISING FUNDS THROUGH THESE CHANNELS HELPS REDUCE THE BURDEN ON DWINDLING PUBLIC CONTRIBUTIONS.

SPECIFICALLY, I AM ASKING THAT YOU LEND YOUR SUPPORT TO KEEPING THE "SUBSTANTIALLY RELATED TEST" AS IS. AS A SMALL BUSINESS OWNER FOR 8 YEARS, I DID NOT FEEL THAT THE MUSEUM TOOK ADVANTAGE OF UNFAIR COMPETITION AND BY NOT CHANGING THE MUSEUM'S EXCLUSIONS TO THE TEST, YOU CAN HELP LAGUNA GLORIA CONTINUE ITS TRADITION OF ART EDUCATION FOR ALL THE RESIDENTS OF CENTRAL TEXAS.

THANK YOU FOR YOUR ATTENTION TO THIS MATTER.

SINCERELY,

David West

DAVID WEST
MUSEUM SHOP MANAGER

LAMBDA RESEARCH INCORPORATED

1111 HARRISON AVENUE CINCINNATI, OHIO 45214-1801 [illegible]933

April 7, 1988

COMMITTEE ON
RECEIVED
APR 11 1988
WAYS AND MEANS

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Sir:

The purpose of this letter is to address an issue before the House Ways and Means Committee relative to nonprofit competition and the unrelated business income tax (UBIT).

As a member of the ACIL and a growing small business concern, Lambda Research is seriously concerned about inequities in legislation relative to testing services, our livelihood. We strongly object to the weak wording for UBIT reform relative to "testing for the public safety." Most of the testing services we provide are related to public safety, and yet we are required to pay taxes on our profits. Please reconsider the wording allowing exemption for "testing for the public safety."

With increasing frequency, we have encountered tax-favored competition which has impacted on our growth. Specifically, university laboratories and their affiliated nonprofit research corporations are now providing routine testing services for the industrial community. We cannot compete with tax exempt organizations which employ staff, facilities and equipment supported by OUR taxes. High technology service businesses, a primary source of jobs and growth in our changing economy, must be allowed to develop without unfair competition.

We would appreciate hearing from you or a member of you staff relative to the subcommittee hearings. Thank you for your consideration of my comments.

Sincerely,

LAMBDA RESEARCH, INC.

Paul S. Prevey
President

PSP:pk

CC: The Hon. William F. Bowen
Senator

The Hon. William L. Mallory
23rd House

Lancaster Laboratories

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

This letter is in response to the Committee's request for comment on the various options for UBIT Reform as listed in its March 31 news release. I shall make general observations and then comment specifically on the discussion options as they relate to my own industry.

I have followed the June 1987 hearings rather closely. Indeed the mood of the Committee at that time reflected a commitment to significant reform of the tax code dealing with non-profits. But now I have the feeling, on looking at the Committee's various options, that they represent a series of Band-Aid measures, in most cases containing enough exception and exclusion qualifiers so that the real problems are addressed only marginally. I will illustrate this later in my specific comments on "testing for the public safety."

I would like to comment on the focus of the recommendations. Their actions seem heavily directed toward 501-C(6) organizations and seem almost punitive rather than remedial. Examination of the hearing record reveals that the major concerns of small business are the blatant abuses of tax exempt status by 501-C(3) organizations, those engaged in major business operations that are inherently commercial. I am distressed to observe that these discussion options seem more a result of belated but intense lobbying pressures applied by the C-3's than of the solid case made in the hearing record by small businesses.

These general feelings can best be illustrated by the Committee's dealing with the concerns of taxpaying testing laboratories. It is my belief that the option relating to

2425 New Holland Pike, Lancaster, Pa. 17601-5994 • (717) 656-2301

"routine testing" would actually weaken our position and would not help in the least to eliminate unfair competition by universities and non-profit institutions. Also, although much was said in the record about the need to define "research" for purposes of UBIT, the recommendations are silent on the subject. The glaring example of non-response to our request has been the Committee's handling of the "testing for the public safety" issue. My laboratory and most other taxpaying commercial laboratories qualify for the "testing for the public safety" tax exemption as fully as does Underwriters Labs or the National Sanitation Foundation. We are not asking that the playing field be leveled by making us tax exempt -- for we are truly a commercial enterprise: but so are UL and NSF! There is simply no rational basis for the "testing for the public safety" tax exemption, and it should be simply removed from the statute!

The Committee's unwillingness to call a spade a spade on this very obvious abuse is disheartening. Unless this issue is addressed, my guess is that you will see Lancaster Laboratories and other taxpaying laboratories converting to 501-C(3) status by reason of their "testing for the public safety" prime function. I don't think that you want that to happen and neither do I. But our level of frustration at this point is high enough that it may well happen if the Committee fails to face this obvious unfairness issue responsibly.

Thank you for this opportunity to comment.

Sincerely yours,

Earl H. Hess

Earl H. Hess, Ph.D.
President

EHH:glh

Laucks
Testing Laboratories, Inc.
940 South Harney St. Seattle, Washington 98108 (206)767-5060

Chemistry, Microbiology and Technical Services

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
US House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

Laucks Testing Laboratories is a small business that encounters daily competition from nonprofit organizations in the area of environmental chemistry and microbiology. The majority of our efforts involves testing for overall public safety.

We not only pay taxes on our operation but also on our profits, as do most of our competitiors.

We feel all organizations should be treated equally and pay their fair share!

We strongly request and urge the subcommittee to delete any exemption for "testing for the public safety".

Sincerely,

James M. Owens

James M. Owens
President

mjt

Charter Member American Council of Independent Laboratories

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(ADMITTED IN NY, OH & MA ONLY)

April 15, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax
Response to Press Release No. 16

Dear Mr. Leonard:

I am writing to provide our firm's comments on Press Release No. 16 by the Subcommittee on Oversight, relating to proposed changes in the Unrelated Business Income Tax ("UBIT") on tax-exempt organizations. We represent certain educational organizations exempt under Section 501(c)(3) of the Internal Revenue Code. These organizations, among their other educational activities, publish magazines which are distributed to their members.

Since its enactment in the Revenue Act of 1950, the UBIT has always been primarily designed to address possible unfair competition by not-for-profit organizations competing directly with taxed enterprises conducting the same activities. House Report No. 2319, 81st Congress, Second Session, P. 36 (1950).

We understand that the Subcommittee likewise is motivated to correct any actual or perceived unfair competition. The Subcommittee's discussion options, however, seem more concerned with raising revenue. Nevertheless, each option should be evaluated to determine if it genuinely would prevent unfair competition, while not frustrating the charitable purposes for which not-for-profit organizations are permitted an exemption under Section 501.

First, I am opposed to the adoption of the "directly related" test as a replacement of the "substantially related" test. It confuses the definition of unrelated business income, and discards a now extensive judicial, administrative, and legislative history interpreting "substantially related". "Directly" is equally, or more, subjective than "substantially". For this reason, instituting the "directly" test will have either the drastic effect of effectively eliminating the exemption for all tax-exempt organizations, or it will have not much practical effect at all (other than to confuse).

For example, the IRS has ruled that a university laundry is as substantially related to the university educational function as is providing room and board for students. For the same reasons, one could argue that a university laundry was "directly related". On the other hand, if "directly" is interpreted to render unrelated all activities other than actual teaching itself (a draconian but plausible interpretation), the result for nearly all revenue producing activities of exempt organizations like providing room and board for students, would be to render those activities taxable. In other words, such a narrow interpretation of "directly" would so subvert the tax exemption organizations receive as to render the exemption meaningless.

On the other hand, if dormitories are "directly" related, and so are laundries (as they should be), what has the change to "directly" accomplished? The substantially related test should be retained.

If the substantially related test is retained, but the options listed as A through L in the Press Release are codified, we first wish to state, clearly and strenuously, an objection to option J, relating to advertising costs. Under this option, the UBIT would be applied to advertising income after the allowance of deductions only for "direct advertising cost". The provision would provide a more burdensome tax on exempt organizations than is imposed on ordinary commercial organizations. In addition, the Allocation Rules change (Section VIII of the Release) that is also being considered, if adopted, would double this extra burden on exempt organizations with respect to their advertising income.

Option J provides that exempt organizations would include advertising income in UBIT, as they now generally do. Significantly, however, the option would only permit deductions from UBIT for "direct advertising costs". The option thus is essentially a modified gross receipts tax that has no place in an income tax statute and which bears no relation to the overriding purpose of the UBIT. It reverses any perceived unfair competitive advantage so as to actually favor commercial organizations. The objective of UBIT for the last thirty-eight years has been to create a neutral tax environment between taxable and tax-exempt organizations engaged in the same activities.

An organization that publishes and distributes a magazine must, to earn its advertising income, have a staff which can prepare articles and other information important to its readers, and which is essential to achieving its educational objective. The organization must have a place to assemble the staff, and to prepare the publication. It requires a significant overhead expense including rent, utilities, insurance, legal and accounting, management salaries and similar items. The organization must also build and retain a membership, which generally are the only "subscribers" to the magazine. If these expenses are not incurred, the organization will have no advertising income because there will be no advertisers interested in advertising in the publication.

Under the framework of present law, advertising income is properly included in UBIT. Just as properly, organizations are permitted to deduct against advertising income a pro rata and appropriate portion of these costs outlined above. At present the regulations provide a fair and detailed formula for determining whether the publication, of which the advertising is only a small component, has produced taxable income. It requires the organization to treat as income not only the advertising income but a fairly allocated share of members dues; and to deduct all related costs of publishing. This results in net income or loss that fairly reflects the financial results of the publication; and which is essentially equivalent to the taxation of commercial tax-paying publishers. Discussion option J could tax amounts that do not represent any profit, but merely operate to reduce the overall loss of the publication. If commercial publishers were required to pay tax on advertising revenues less only direct advertising costs they could not survive. Indeed, one of our more sagacious clients, speaking only partially tongue-in-cheek, suggested that under option J his organization would spin off their magazine to a taxable subsidiary to save taxes!

If the intent is to put exempt organizations on a level playing field with commercial organizations with respect to inherently commercial activities, this measure fails. The present law should not be changed.

Similarly, with respect to Item VIII, proposing a change in the allocation rules, the same logic dictates that such change not be adopted. The allocation rules proposed discriminate against exempt organizations by denying them equivalent deductions otherwise allowed to taxable entities. Accordingly, it also reverses rather than eliminates the unfair competitive advantage created by the tax law.

We would comment briefly on option III which would repeal the "regularly carried on" test. It is conceivable that occasionly a large venture which is not regularly carried on could create an unfair competitive advantage. But generally these events are normally small fund raisers, such as picnics, banquet programs, field trips, theatrical events, historical site tours, etc. We are sure that the Subcommittee is not interested in taxing such items. These could be specifically excluded or an exemption provided for revenues under commercially significant levels. However, the most practical approach is to maintain the regularly carried on test, well-established under current law, which automatically provides a common sense dividing line between legitimate occasional events and inherently commercial activities which threatens full tax-paying organizations.

Finally, we would comment on Item L which refers to unspecified "additional specified activities" by expressing our concern for the "surprise factor" that may result. We think any other activities to be considered should first be defined and then be the subject of advance public notice.

Thank you for your consideration of these comments.

Very truly yours,

Arthur K. Mason

AKM/djm

JOE CHANDLER-PHARMACIST
& HEARING CARE CENTER
407 VAN BUREN RD.
(919) 623-8445 EDEN, NC 27288

APR 9 1988

ROBERT J. LEONARD, Chief Counsel
Comm. on Ways & Means
U.S.House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

RE: UBIT REFORMS

SIR:

I do not excuse this "stationary" since, with NON-PROFIT ORGANIZATIONS taking our profit FROM WHICH I PAY HEAVY TAXES.....I am not sure we will be able to afford printed letterheads any longer !

Yes, the above is to catch your attention, HOWEVER....MAKE NO MISTAKE its very, very serious that we tax-paying SMALL BUSINESSMEN.....MUST have your help in subjecting NON PROFIT ORGANIZATIONS from using their tax exempt status to drive us out of business while most of them I am aware of, CHARGE MORE THAN FOR PROFIT BUSINESSMEN for services !!! TRY N.C. BAPTIST HOSPITAL in Winston-Salem for size : audiometric exam WAS $ 125- to $175.00 PER VISIT ! Ours ?? $ 25.00 with the same results !

I do not intend spending agreat deal of time nor space on this because I am aware, I think, of the thinking of most "representatives" in the House.... an atrocious example of NON-AMERICANISM if there ever was one ! I may lose on this but so will the person looking for SERVICES that will be found miles and miles away, costing the Government far, far more than you save (sic) by bleeding hearts who, in reality , believe Socialism works better than Capitalism; which is complete bull chips ! See history as ALL examples.

Having alineated some of you folks I still ASK....nay, beg...that you wake up and HELP US SMALL BUSINESSMEN at least once in my lifetime : by passing UBIT recommendations TO STOP ....NON-PROFIT ORGANIZATIONS from COMMERCIAL HEARING AID SALES and further to repeal the existing "CONVENIENCE" exemption for patients or recognize them as IN-PATIENTS ONLY.

Once upon a time we had referrals from N.C. Baptist Hospital , UNC -CH Memorial Hospital, etc. but no more .... they take the profit (COMMERCIAL) and pay NO TAX !) I compete with this government in : PRESCRIPTIONS, RENTAL APARTMENTS AND NOW HEARING AIDS. I can't stand anymore, COULD YOU ?????

MOST SINCERELY,
Joseph Chandler
LISBETH, INC.

National Headquarters
5795 Widewaters Parkway
Syracuse, New York 13214-1846
Telephone (315) 445-8000

Founder
Ruth J. Colvin

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Wally "Famous" Amos

April 14, 1988

The Honorable J. J. Pickle
Subcommittee on Oversight
1105 Longworth House Office Building
Washington, DC 20515

Dear Congressman Pickle:

As Chairman of the Board of Directors of Literacy Volunteers of America, Inc., (LVA) an organization in the forefront of the battle against illiteracy, I wish to bring to your attention the disastrous effect certain Unrelated Business Income Tax proposals the Committee on Oversight is considering would have on our program.

As a non-profit, educational organization, our exempt purpose is to provide literacy materials and services so illiterate adults can learn to read. We have a small paid staff; our program is implemented by 25,000 volunteer tutors who use our training and educational materials.

Because our mission is to provide adult literacy teaching materials to a national clientele, virtually all of our sales are through mail order. I urge you to remove the provision that would find catalog and mail/phone orders taxable, regardless of purpose. The test for UBIT should be whether or not the sales are an integral part of the exempt program; method of distribution (on premises vs. off premises) is not a rational basis for determining UBIT. A clear statement is needed that the sale of educational materials to a specialized public, regardless of the method of distribution, is not subject to UBIT. If there is an abuse by some organizations deriving income from sales that bear no relationship to their work, corrective legislation should be carefully drawn to eliminate those abuses without hurting organizations like LVA where sales are an integral part of our work.

In addition, a non-profit organization like ours which is supported largely by the private rather than the public sector should not find itself subject to UBIT for clearly exempt activities. Income from advertising of educational materials and royalties from educational materials we produce should not be subject to UBIT. Our 300 local affiliates who provide tutoring to teen and adult non-readers in their local communities desperately need to be able to raise funds to support their program with special events that are "not regularly carried on" without the imposition of UBIT.

We urge that reporting requirements be kept simple and brief, so that money which should be spent for program is not diverted to record-keeping.

Thank you for considering the needs of adult literacy education as you prepare your legislative proposal.

Sincerely,

Arthur Bongiovanni

Arthur Bongiovanni, Chairman

Enclosures [Enclosures are being retained in Committee files.]

Los Angeles Theatre Center
BILL BUSHNELL, ARTISTIC PRODUCING DIRECTOR

15 April 1988

Honorable J. J. Pickle, Chairman
Oversight Subcommittee
U. S. House of Representatives
Washington, D. C. 20515

Dear Chairman Pickle:

I am writing to you in my capacity as Artistic Producing Director of the Los Angeles Theatre Center about a situation that threatens the earned income of many non-profit arts organizations.

I refer to the Unrelated Business Income Tax (UBIT) which is being considered by the Oversight Subcommittee at the present time. This tax, if imposed, could be detrimental to Theatre Center revenues in the following areas:

--a variety of on-premise gift shop sales;
--all off-premise sales, such as mail-order ticket sales, which would severely impinge on potential revenues;
--royalty income that is the result of net rather than gross income or that is derived from licensing the use of property rights that an exempt organization created, or was substantially involved in developing or marketing;
--advertising in programs for performances and other publications (deductions for losses on the readership content of the publication would not be allowed, even if the advertising is not regularly carried on);
--most tour services;
--mail list exchanges and rentals, even between non-profit groups; and
--low-cost items (such as t-shirts and key chains) used in contribution drives.

In addition, the options discuss possible changes in allocation rules for activities (i.e., facility rentals), such that any share of general overhead and depreciation would be disallowed. The options also suggest, without further explanation, that "additional specified activities" will be subject to UBIT--a disturbing absence of specificity, to my mind.

514 SOUTH SPRING STREET

LOS ANGELES, CALIFORNIA 90013

213-627-6500

All of these options could have an adverse affect on the earned income portion of the Theatre Center's budget, not to mention the increased time and paperwork that go into compliance with new, more complex, and wide-ranging tax categories.

In a period when non-profit arts organizations are under the gun to raise the level of earned and contributed income (and when the difficulties of achieving this balancing act are strenuous as never before), the imposition of yet another tax upsets the delicate balance we attempt between earned and contributed income. If a tax is imposed on portions of our earned income, that balance is upset, and the very basis for having tax-exempt status is destroyed by an arm of the government that should be protecting this special status for the public benefit.

If this legislation is adopted, the overall effect on arts organizations will be devastating. I urge you, in all conscience, to vote against this option as a measure that will unfairly penalize the non-profit organizations that most need your support and protection.

Sincerely,

Bill Bushnell

Bill Bushnell
Artistic Producing Director

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

I just had the opportunity to read Press Release #16, Subcommittee on Oversight, Committee on Ways and Means re the subcommittee preliminary decision on the unrelated business income tax that applies to non-profit organizations.

I'm not personally qualified to comment on the various options, however, as an owner of three small businesses, from 5 to 65 employees each, I'm adamantly opposed to a non-profit organization selling goods and services in competition with "for profit" businesses. It is most difficult for me to understand this rational.

As the taxes increase in years to come, the problem between non-profit and for-profit businesses will magnify even more.

I encourage the committee to approach this problem with diligence and correct this serious situation from growing rampant as it does each year.

Thank you for the opportunity to express my feelings.

Sincerely,

Floyd Loupot

Floyd Loupot

FL:L

2231 Kinclair
Pasadena, Cal. 91107

cc:Congressman Carlos J. Moorhead
David Dreier

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April 8, 1988

The Hon. J. J. Pickle, (D. Texas)
Chairman, Subcommittee on Oversight
Committee on Ways & Means
U. S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

Dear Congressman Pickle:

Your desire and ivitation for public comment on the matter of Unrelated Business Income Tax by non-profit organizations in our nation, is appreciated.

Before citing specific named organizations of which I am both a member for many years, the overall picture is one where both entreprenurial and (dis)ingenious spirit of certain persons come together to exploit what they (sincerely) believe is either a perfectly legal and appropriate business decision to raise funds for their organization and in some instances become so sucessful as to build entire bureaucracies of (salaried) workers to process their efforts.

Between 1957-1969, as a General Sales Manager for a major international airline, I was surprised and later apalled for by the number of non-profit production line offices which I called on promoting travel and transportation services, far beyond the need or capacity of their own membership, all without the benefit of a tax burden.

Specifically, a means of improper competion to the extent that:

(1) The non-profit is not even chartered to perform extraneous travel promotions to the general public, and

(2) Have accumulated vast sums of monies, mostly deposited with financial institutions earning tax free interest, and

(3) Convey to members and the public alike that partonizing their particular product or service is a social benefit and good deed to assist the preservation of "this" or "that".

Here is a case study. Railroad enthiasts (buffs) formed over fifty years ago several organizations which exist to this day. One, the **National Railway Historical Society"** (NRHS), has over a hundred chapters and 30,000+ members. Various chapters organize trips using historic equipment and legitimately mark-up their trips to raise monies for restorative work on buildings, equipment and other museum related projects. All very noble.

These groups have amassed literal fortunes in banks with no plan and no prodding from audits by the IRS as to how and when they would spend these funds as the law clearly imputes. Congress should mandate to the IRS that 501(C)3 and 7 organizations should be required to submit annual plans for the spending of funds acquired from operations involving the sale of property or transportation. The financial institutions in which these funds are placed should likewise be reporting interest income. Further, backup withholding should be required by all financial institutions for all non-profits who would receive refunds if they met certain tests.

I have always felt that a ceiling should be placed on how much business derived income any non-profit should be allowed and that a spending plan for their noble works ought to be annually proctored.

It seems the present laws are simply not enforced and may be one way to lessen the attraction is to withhold and then require an accounting. Judging the wailing of the non-profits to keep the status qyuo, the handwriting seems to be clearly on the wall.

The NRHS decided to license the sale of international travel tours some years ago, by permitting one chapter, (Midwest), to become a stock corporation, full subject to tax, get the benefit of the **"same name umbrella"**, i. e. NRHS, clearly creative tax avoidance since the project would be meaningless without the 95% non-profit organization both licensing the project, carrying cost free advertisements and reselling it to the general public.

The matter of unfair competition is two fold; first absence of taxation and breaching their own corporate charter which does not embrace peripheral and unrelated business activities. Congress should require that corporate charters be submitted in connection with initial 501(C)3 and 7 filings to make window dressing and other posteriori changes well nigh impossible without endangering their special statuses.

Please do not hesitate to contact me for any further details you may wish.

Cordially yours,

LURAY TRAVEL BUREAU

KWH/bhs

Karl W. Helft, M. Inst. T.
President

CHARLES H. MacNIDER MUSEUM

303 SECOND STREET SOUTH EAST
MASON CITY, IOWA 50401
Phone (515) 421-3666

April 14, 1988

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Chairman Pickle:

I am very concerned about present considerations for changing the unrelated business income tax provisions relative to nonprofit organizations such as museums. I am afraid that some of the options being considered, if enacted, would be extremely detrimental to the activity of such organizations, ultimately diminishing the effectiveness and the success of their efforts for the benefit of the public at large.

Museums, for example, are an integral part of the nation's educational and recreational systems providing a great deal of life enrichment opportunity through both formal and informal avenues. Museums are available to and reach people of all ages, all backgrounds, and of every social, economic, or political persuasion. They are the carriers of our nation's heritage, our technical, intellectual, and artistic accomplishments and of our dreams. Most today find themself extremely hard-pressed by competition for operating funds.

While costs have risen, avenues to resources, charitable and otherwise, have been closed, limited, and modified in so many ways that museums find it more difficult every day to pursue their worthy missions. The operation of gift shops, bookstores, sales/rental galleries, and the offering of other special services and programs under a tax-exempt status has been a key in many cases to museums remaining viable. I hope the members of the House Ways and Means Oversight Subcommittee will weigh carefully the ramifications of any of its actions relative to the unrelated business income tax laws. Museums especially could be seriously and adversely affected in carrying out their roles as providers of a unique form of continuing education and enrichment and as the nation's repositories of cultural objects.

Sincerely yours,

Richard E. Leet
Director

cc Representative Fred Grandy

Madison Art Center 211 State Street Madison, Wisconsin 53703 608/257-0158

April 11, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to express my concern regarding the proposed legislation regarding Unrelated Business Income Tax for non-profit organizations.

Although I can understand the concern expressed by commercial businesses regarding the unfair competition some might perceive from non-profits, I feel that if this tax is instituted it would most definitely have an economically adverse effect on our own institution which has to struggle as it is to provide the services we do to our community.

If by chance this type of tax is enacted, I do hope that at least some serious thought be given to placing a minimum income level when determining tax liability.

Any sort of income tax is certainly going to be felt more dramatically by smaller organizations and one way to help ensure the continued existence of those smaller non-profits is to determine some sort of minimum income level, of say $500,000 to $1,000,000.

I hope you find an equitable solution to the situation, one that will not have any adverse effect on those non-profits that provide so much positive service to their communities.

Sincerely,

M. J. Paggie

Michael J. Paggie
Acting Director

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

I am the owner of a small business. I have been in business for 43 years, and it is quite upsetting to have these so-called "non-profit" organizations, such as clinics connected with hospitals and others who claim that they are non-profit, competing against me in the hearing aid industry.

It seems to me that it is time for the Federal Government to start collecting taxes from these prople and institutions that we are supporting.

I hope that you and the Committee on Ways and Means can surely act on this very grave problem.

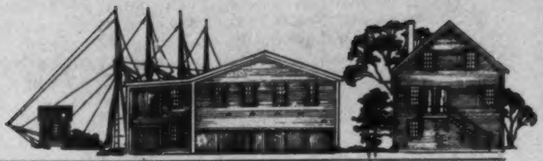
Thank you for your consideration in this matter.

Sincerely yours,

Albert L. Mattingly

Albert L. Mattingly
Maico Hearing Aid Service of Spfld, Inc.

ALM/ral



MAINE MARITIME MUSEUM / Washington Street / Bath, Maine 04530 / (207) 443-1316

11 April 1988

The Honorable J.J. Pickle
Chairman of Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Chairman Pickle,

I recently received notice regarding public comments on options relating to the unrelated business income tax.

In the first place, I would like to present a little perspective as a small history museum director in a small state (by income and population standards). Over ninety percent of our collections and forty percent of our income flow through the Museum by donation. The recent tax law changes really affected us adversely as far as donation of appreciated property (ie. our collections). In addition, we have watched a constant Administration barrage against funding for the Endowments and the Institute of Museum Services. My sincere appreciation to Congress for continuing to recognize the real worth of these organizations.

Now we are looking at a variety of other ways in the postal department and again in the UBIT to squeeze yet a little more income out of our cultural institutions. I have to tell you it really hurts. We don't mind having to compete for funding and earned income out there in the marketplace, or even competing with profit making attractions for earned income, but every little bit helps, especially when you are delivering important services such as interpreting Maine's maritime heritage to the community.

Our income from admissions pays 20% of my overall operations cost and should we raise the price we'll keep out more members of the community who have the right to participate in our programs. Thus, related activities helps provide us additional needed funding. Earned income from UBIT exempt activities helps to fuel this place in order for it to truly serve the community, the state and the region.

In looking at the substantially related test we would be hurt through the operation of our giftshop and perhaps more importantly, the sale of traditional vessels built in our Apprenticeshop training program. Unique in the country, the program offers a "labor for learning" tuition and the Museum sells the wooden boats built in the program to help fund it's operation. For Maine and our region, this program is important for the marine businesses who are able to depend upon the quality employees we graduate from the program. It barely runs itself now and additional tax monies, while not adding to the federal deficit, would probably be enough to put the program out of business. There are not many programs in the United States where traditional skills are passed on in this fashion. It would be a tragedy to lose this one.

At the same time, the tax would affect seriously the small amount of travel tours the Museum hosts. The income is not much from these, but again, they are an offering to the community and are of an educational nature, promoting maritime education to our members and friends.

If the convenience exception is repealed our institutions lose yet more ground in being able to assist their members and friends in a variety of ways that are not wholly income producing, but again, enable your organization to be able to do a little extra for the people who keep the doors open. I'm not worried about the large institutions so much, but the smaller ones like ours where every service you can offer helps to bring in the necessary support.

Likewise, repeal of the "regularly carried on" test would eliminate small organizations from entering into new ventures to help support their activities. Museums have moved closer to following business trends and programs in their activities, it is essential for their growth and survival in this day and age. They need to be able to seize opportunities presented in the present tax code and maximize their support. The current code is more than sufficient in regulating these activities, in my opinion.

Royalty income provides my organization with a moderate amount of support, Again it is so little that we question our motives. But in reality, our motives are to offer as wide a variety of options for participation to our constiuency as we are able. To tax these activities would push them beyond the scope of our possibility and in all likelihood begin the potential for a wide range of decay in support.

In closing and looking at other options open to the Committee that do not currently affect my small institution, I must report that these options do not seem necessary to me at this time and it is doubtful that the majority would ever be necessary. On the whole, the options if enacted, would be self defeating because the majority of institutions, particularly the smaller ones like mine, would simply close up shop in those areas. Our constituency, and yours, would then lose a benefit to a convoluted reporting scheme or simply the activity with the UBIT would no longer be feasible because it would not pay for itself any longer.

In Congress in recent years there have been few new initiatives to actually help our beleaguered small cultural institutions. Believe me, I appreciate the funding levels that have been sustained and the new funding for the National Science Foundation, which should help science museums. However, a small history museum director, in a state which simply cannot afford to give strong support to the arts, I need to be as creative as possible in finding the cash to not only keep the doors open, but provide stimulating, progressive programming at a competitive price. In our society people no longer come to museums because its the "thing to do", particularly history museums, but they come primarily to be entertained or because to the majority, we can offer that "little something extra", an educational tour, the perfect maritime gift or a particular service. As I said, these activities will not mend the federal budget, but they do keep my doors open 363 days a year at a reasonable price.

I thank you for your consideration in this matter.

Sincerely,

John S. Carter

John S. Carter
Director

JSC/pic

APR 06 1988

MARSHALL
MEMORIAL
HOSPITAL-H.C.H.A. Inc.

March 29, 1988

The Honorable Jake Pickle
House of Representatives
242 Cannon House Office Bldg.
Washington, D.C. 20515

Dear Mr. Pickle:

I am writing in opposition to the proposed Ways and Means Committee action on unrelated business income tax legislation. I am opposed to this measure for the following reasons:

1. The hospital's responsibility for the individual begins at the point of service relationship with the staffers regardless of whether this requires placing a person in a hospital bed.

2. The definition of "patient" should encompass all individuals who receive healthcare services to which the hospital is responsible. Hospitals are clearly responsible for delivering services on an outpatient basis.

I also feel that sell or lease durable medical equipment to patients should remain tax exempt for the same reason that the present law convenience exception should stand. Provision of durable medical equipment to patients is an essential part of healthcare delivery.

I hope you will consider my objections to the proposed legislation, and will act in a way that will both better serve the patient and the healthcare system.

Respectfully yours,

Sam L. Oney

Sam L. Oney
Administration

SLO:st

811 South Washington Avenue • P.O. Box 1599 • Marshall, Texas 75670 • (214) 935-9311

FABRIC CARE SPECIALISTS
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EXECUTIVE OFFICES: 515 North 12th Street • Allentown • Pennsylvania 18102 • Telephone 215 437-5435

April 5, 1988

APR 12 1988

The Honorable J. J. Pickle
United States House of Representatives
Washington, DC 20515

Re: Revisions to the Unrelated Business Income Tax (UBIT)

Dear Representative Pickle:

I am writing to you as a taxpaying businessman in the textile rental (linen supply and industrial laundry) industry to express my concern over a growing problem that is affecting my business. That problem is unfair competition from tax-exempt organizations, specifically, nonprofit hospital laundries.

Most recently on March 16, 1988, my company participated in a bid opening for the Laurelton Center State Hospital located in Laurelton, Pennsylvania and was shocked to again find a nonprofit laundry called Hope Enterprises from Williamsport, Pennsylvania competing for this business. We were further appalled to find that their bid was 34% lower than the one submitted by my multi-plant company; further evidence of the inequities that exist in the private business sector.

In June of last year, the Textile Rental Services Association of America (TRSA) testified at the House Ways and Means Oversight Subcommittee's hearings on the Unrelated Business Income Tax (UBIT). At that time, TRSA recommended that Congress tighten the tax laws to prevent tax-exempt organizations in the health care market from soliciting laundry business away from taxpaying for-profit commercial laundries. (Enclosed is a copy of TRSA's opening statement which summarizes the nature of the commercial activity of the tax-exempt laundry competitor.)

It is my understanding that the Ways and Means Oversight Subcommittee is preparing recommendations for consideration by Ways and Means Chairman Rostenkowski.

On behalf of my company and the textile rental industry, I urge you to consider the following recommendations.

1. Nonprofit hospitals should not be allowed to offer laundry services to any outside entity.

2. Recognized accounting practices must be required for all existing nonprofit corporations engaged in activities generating unrelated business income so that taxable profits can't be hidden.

3. Nonprofit hospital laundries must be required to pay their fair share of local property, sewage and water taxes and other costs.

The textile rental industry is willing to compete fairly but we object to a system that takes our hard-earned dollars and uses it to fund a nontax-paying, unfair competitor.

Very truly yours,

MARY MacINTOSH SERVICES, INC.

Arnold R. Kuthy

Arnold R. Kuthy
President

ARK:cma

Enclosure

cc: Representative William J. Coyne
Representative Richard T. Schulze
Senator Arlen Specter
Senator John Heinz
Representative Donald L. Ritter

Elizabeth A. Whittleton
Manager of Legislative Affairs
c/o Loomis, Owen, Fellman & Howe
2020 K Street, N.W., Suite 800
Washington, DC 20006

[See Printed Hearing 100-27 for Enclosure]

MMR
Massachusetts Materials Research, Inc.
P.O. BOX 810 • 241 WEST BOYLSTON STREET • WEST BOYLSTON, MA 01583 • TEL. 617-835-6262

April 7, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1101 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I think it is very important that non-profit organizations pay taxes on their "Unrelated Business Income".

My business is often forced to compete with non-profit organizations. We are a testing laboratory and some organizations that compete with us charge very low prices, using untaxed equipment and disregarding true expenses, and take the business from us. I think this is unfair. Then, at the end of the year, we have to pay income taxes on any profit we make on this type of work; while the non-profit organizations pay no taxes at all.

We have lost significant amounts of business over the years to non-profit institutions that take advantage of their tax free status to charge lower prices.

We are very much concerned also that all companies doing testing should be treated alike. The exemption for "Testing for the Public Safety" should be deleted. The discussion option is really nothing at all.

I believe any type of commercial activity should be subject to income tax, whether it is performed by a "For-Profit" company or whether it is performed by a "Non-Profit" organization. If everybody paid income taxes on all the commercial activities done in this Country, we probably wouldn't have a big deficit to worry about.

Sincerely yours,

David Krashes

David Krashes
President

DK/pkt

MASTER PLAN HEARING AIDS, INC.

LICENSED HEARING AID DEALER

1125 GRAHAM ROAD
FLORISSANT, MISSOURI 63031

Phone: (314) 837-5796

Robert J. Leonard, Counsel
Committee on Ways Mnd Means

4-11-88

Bear Mr. Leonard,

First let me commend the committee on its intense work on reform measures. I realize some of the complex problems involved in regulating non-profit sales.

I want to encourgge the sub-committee to apply UBIT to all hearing aid sales income of nonprofits. Hearing aids are a commercial venture and have been since their origination. The hospitals in our area have all began selling hearing aids commercially, and yet do not pay corporate taxes that I do. Initially, we had three offices, now do to the intense competition, we have only one, and the drop in sales has been devastation for our business.

I request your consideration to repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

In short, the nonprofits who now sell hearing aids, use the advertising power of their hospitals to effectively reduce the business of those of us who cannot afford to promote in the same economical manner. I implore the sub committee to help the small tax paying business in a fair and equal manner. Thank you for your consideration.

Cordially,

Ken Jones

Ken Jones, President.

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April 14, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax
Response to Discussion Options

Dear Mr. Leonard:

MasterCard International, Inc. and VISA U.S.A. Inc. are membership organizations comprised of financial institutions that are licensed to use the MasterCard and VISA service marks in connection with payment systems, including credit cards. In recent years, member financial institutions have entered into programs with tax-exempt organizations through which the members may offer credit cards to the exempt organizations' members, contributors or supporters.

This letter is in response to the Subcommittee on Oversight Press Release dated March 31, 1988 requesting comments on several "discussion options" relating to the unrelated business income tax ("UBIT"). Specifically, this letter analyzes the proposal to apply UBIT to income from affinity credit card programs and to royalty arrangements in general.

Under a typical "affinity card" program, an exempt organization allows a financial institution to issue a credit card that is identified with the exempt organization. The name and/or the logo of the exempt organization is prominently printed on the credit card and the promotional materials refer to the credit card program as one that is associated with the exempt organization. The exempt organization and financial institution negotiate the terms of the credit card, e.g., annual fee and annual percentage rate, and the exempt organization has the right to approve the promotional materials describing the credit card program that are prepared by the financial institution.

The exempt organization allows its name to be used on the promotional materials and may endorse the product, and the financial institution typically incurs substantially all of the promotional and mailing costs. The exempt organization typically permits the financial institution to use its mailing list of members, contributors or supporters for purposes of the promotion only, and the financial institution is prohibited from using the membership list for any other reason.

In exchange, the exempt organization receives specified amounts that depend on income generated from the program. Typically, the exempt organization receives a specified sum for each credit card that is issued. In addition, the exempt organization may receive a specified percentage of the total charges made by the card member and/or a specified amount each time a member renews the credit card. In some affinity credit card arrangements, the financial institution pays a separate flat amount for the right to use the exempt organization's mailing list.

As we understand it, the impetus for the Subcommittee's review of the UBIT area is a Congressional concern that exempt organizations have increasingly conducted activities of a commercial nature that have directly competed with taxable business entities that are at an obvious economic disadvantage because of their taxable status. We suggest that this concern does not apply to traditional royalty arrangements like affinity credit cards for several reasons.

The original Congressional distinction between active business operations and passive investment income remains valid. Current law recognizes that passive income derived from an investment generating interest, dividends or royalties may represent a "for profit" activity but does not rise to the level of a business activity; therefore, current law expressly excludes passive income from UBIT. See S. Rep. No. 2375, 81st Cong., 2d Sess. 30 (1950).

Even under current law, an exempt organization that participates too much in a business activity is subject to UBIT even if the arrangement is structured as a royalty. See e.g., Fraternal Order of Police Illinois State Troopers Lodge No. 41 v. Commissioner, 87 T.C. 747, 757-58 (1986); Disabled American Veterans v. United States, 650 F.2d 1178, 1189 (Ct. Cl. 1981). Thus, no legislative change is needed to impose UBIT on truly commercial activities disguised as a royalty.

Conversely, under a traditional royalty arrangement, the licensor merely provides its licensee with the right to use intangible property. And though the licensor can retain the right to approve the quality or style of the licensed products or services, it is the licensee that actually operates the business.

There is little distinction between a traditional royalty*/ and the other types of passive income that would remain tax exempt under the Discussion Options. Just as interest income represents compensation for the right to use money, a royalty represents compensation for the right to use intangible property. When an exempt organization deposits money in a financial institution, the institution engages in business activities and pays the exempt organization interest from the proceeds of such business. Similarly, a licensee engages in the business of manufacturing products and compensates the licensor for the right to use the intangible property that it has licensed from the licensor, e.g., a logo. The same analogy can be made with respect to an exempt organization's receipt of dividends in exchange for the corporation's use of the exempt organization's capital contributions.

---

*/ For these purposes, we assume that a traditional royalty is paid based on the gross sales of the licensee. We concede that a royalty based on the net income of the licensee subjects the licensor to the risks of the licensee's business and is therefore closer to participating in a business. Thus, we would not oppose a legislative change taxing royalties based on net income.

Further, a licensing arrangement is much less of a business activity than other types of passive income that would remain tax exempt under the Discussion Options. The clearest example of this type of activity is rents from real property.

An exempt organization has at least two options with respect to real property rents. The organization can operate the property, e.g., a large office complex, on its own and retain a full staff to conduct the necessary operations of the property, e.g., janitorial services, security services, air conditioning, heating and leasing. Alternatively, the exempt organization may lease the entire office complex to a prime tenant and base its rental on the gross rentals the prime tenant receives from its subtenants. Under either alternative, the exempt organization does not pay tax on the rent payments that it receives.

Under the first leasing alternative, the exempt organization engages in what is ordinarily considered an ongoing business enterprise and has a large staff performing leasing and management services, activities that are generally considered to be commercial in nature.

Conversely, an exempt organization typically only enters into one or two affinity credit card arrangements and spends little time reviewing the solicitation materials prepared by a financial institution. Moreover, after the solicitation, the affinity group engages in no activities whatsoever other than receiving licensing payments.

Under the second leasing alternative, the exempt lessor receives income only to the extent that the prime tenant receives rent. Similarly, an affinity group typically receives payment only to the extent that the licensee financial institution generates income from its credit card operation. If anything, an affinity credit card program is more similar to the second leasing alternative than the first, and it is clear that under the Discussion Options rents received under the first alternative would remain exempt even though the exempt organization's activities are more commercial in nature than an affinity credit card program.

An affinity credit card program lacks one of the essential elements found in virtually all the other Discussion Options, namely, competition with taxable entities. Unlike the other "inherently commercial" activities listed in the Press Release, an affinity group does not operate a business that competes with a taxable entity. Rather, the financial institution that issues the credit card with the affinity group's name and/or logo is the entity that conducts a trade or business and is taxable on any income generated by that business. Indeed, we are not aware of any financial institutions that have complained that affinity credit card programs unfairly compete with their businesses.

The Discussion Option relating to royalty income would tax royalties on a scope far broader than just affinity credit card programs. Many types of fundraising arrangements are in substance identical to affinity credit card transactions, and we believe any attempts to tax such arrangements would be inappropriate.

For example, many exempt organizations permit their names and/or logo to be used on merchandise (e.g., on boxes in which products are packaged) and receive payments based on the sales of such products. The business that makes such payments to the exempt organization widely advertises that a percentage of its sales will be contributed to the exempt organization. As with an affinity credit card program, the exempt organization does not take an active business role but instead merely permits a taxable business entity to use its name or logo in a passive manner.

Another variant of this fundraising mechanism is income from so-called "cause related sources," in which a taxable business announces that it will contribute a specified sum of money to an exempt organization based on its sales during a given period. Once again, the exempt organization does not engage in a trade or business, but apparently would be taxed under the Discussion Option because it would receive payments for the right to use property it created, i.e., its name and/or logo.

There is no apparent public policy for taxing such mechanisms for generating corporate charitable contributions. Over the past several years governmental funding of exempt organizations has steadily eroded. This decline of governmental support has placed pressure on exempt organizations to maximize its efforts to solicit support from the private sector. A corporation's generous offer to contribute funds to an exempt organization should not be diluted by treating such contributions as taxable royalties for that organization's express or implied endorsement of the corporation's products. Any such imposition of UBIT would severely retard the exempt sector's ability to solicit business contributions in the future.

Last, an exempt organization's solicitation prospects increase to the extent that a member of the public closely identifies with that organization. One of the reasons that affinity groups participate in affinity credit card programs is to increase the identification of a member, contributor or supporter with that exempt organization. The regular use of a credit card that bears the affinity group's name and/or logo is a constant reminder to the cardholder that he or she is a member or supporter of that affinity group.

This affiliation aspect of an affinity credit card program enhances the exempt organization's solicitation prospects and therefore furthers the exempt organization's exempt purpose. Although this relationship aspect of an affinity credit card program is not necessary under the current law exclusion of royalties, such nexus provides another tax policy reason why such programs should not be subject to tax.

In summary, the current law exclusion of gross royalties is consistent with a sound tax policy of permitting tax-exempt organizations to passively invest their property without being subject to tax. We believe that any changes to this policy would be unnecessary and inappropriate.

Thank you for this opportunity to present our views.

Sincerely,

Tony M Edwards

Tony M. Edwards
Counsel for
MasterCard International, Inc.
and VISA U.S.A. Inc.

McQueen's Hearing Aid Center
234 West Depot Street
Greeneville, Tennessee 37743

The Honorable J. J. Pickle, Chairman
House Ways and Means Subcommittee
1105 Longworth House Office Building
Washington, D. C. 20515

Dear Sir:

Thank you and your committee very much for the excellent package of reform measures that you have put together. Hopefully, all of these measures will be included in your final report, and that UBIT will be applied to all hearing aid sales income of non-profits. Further, the "convenience" exemption for patients will be repealed or patients will be recognized as inpatients only.

Hearing aid dispensers in Tennessee are disturbed about commercial hearing aid sales by non-profit organizations throughout the state because these organizations are dispensing hearing aids at a lower cost to clients, yet still showing a profit. Some of these organizations in East Tennessee are Mountain Region Speech and Hearing Center, Bristol Speech and Hearing Center and Kingsport Speech and Hearing Center.

Again thank you for all your efforts.

Sincerely yours,

Ann K. Lacy

Ann K. Lacy
Certified Hearing Aid Audiologist

Copies to:

Robert J. Leonard
John J. Duncan
Richard D. Jones
Richard L. Clark
Tom Moyer
Cliff Shaw

MEI - Charlton, Inc.

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13 April 1988

US House of Representatives
Ways and Means Committee
Attention: Robert J. Leonard,
Chief Counsel
1102 Longworth House Office Building
Washington, DC 20515

Mr. Leonard:

I am sure that the Oversight Subcommittee of the House Ways and Means Committee on Unrelated Business Income Tax has received staggering amounts of mail and personal contacts from those who stand to gain the most if changes are not made. These of whom I speak are the nonprofit organizations.

Most likely you have had fewer comments from the small business community since the subcommittee received testimony. You may ask yourself why. Obviously, the nonprofits are using other people's money and other people's time for their extensive lobbying and arm twisting. Small businesses can hardly afford to compete with this approach. We must work to afford the privilege of taking time off to engage in the political arena.

But, let me assure you, small business still cares. Small business still demands that nonprofits play on the same field and by the same rules. Small business needs your help as much as you need ours. I urge you and the subcommittee to find and report in favor of the tax reform of the unrelated business income tax.

Again, let me assure you, SMALL BUSINESS CARES.

Cordially,

MEI-Charlton, Inc.

Don Valley

Don Valley, P.E.
President

DV:ksb

dc: Joe O'Neil, American Council of Independent Laboratories

0.1.1/5213

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Memorial Care Systems
7737 Southwest Freeway, Houston, Texas 77074

March 24, 1988

MAR 31 1988

The Honorable Jake Pickle
Chairman of Subcommittee on Oversight
U.S. House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515

Re: Opposition to Changes in Unrelated Business Income Tax Proposal

Dear Mr. Pickle,

We at Memorial Care System of Houston, Texas wish to express our opposition to changes in the unrelated business income tax rules. The two most possibly injurious recommendations that would impact us and other hospitals are the changing of the definition of "patient" to mean "inpatients" only, for purposes of the convenience rule; and creating a rebuttal presumption that income generated from durable medical equipment sold or leased for use off the premises of the hospital is unrelated business income.

We wish to follow the American Hospital Association on these key issues and they are:

1. Limiting the convenience rule only to inpatients contradicts well-established health care practice and the hospital obligation to provide health care services in the most effective and efficient manner.

    * A hospital's responsibility for an individual begins at the point a service relationship is established regardless of whether this requires placing a person in a hospital bed.

    * The definition of "patient" should encompass all individuals who receive health care services for which the hospital is responsible. Hospitals are clearly responsible for delivering services on an outpatient basis.

    * Medicare and private payers have encouraged the use of hospital outpatient settings as a more appropriate and less expensive setting than inpatient settings for delivering many services that previously were provided only or primarily on an inpatient basis.

    * The rationale for limiting the convenience exception equates outpatients with nonpatients, and is aimed at the "questionable activities of hospitals... which perform blood tests on nonpatients." The severity of surgical procedures done on an ambulatory basis should not be underestimated. The vast majority of procedures done on an ambulatory basis are severe enough that they are ordinarily performed on an inpatient basis but can, consistent with sound medical

practice, be performed on an outpatient basis for far less cost.

2. Limiting the convenience exception would completely disregard the current IRS interpretation of whether an individual who receives goods or services from a hospital is a "patient" for purposes of the convenience rule.

    * Through a number of Revenue Rulings, the IRS has interpreted the term "patient" to include both inpatients and outpatients for purposes of the convenience rule.

    * The IRS has also identified situations in which a person is not a patient of a hospital; e.g., persons purchasing pharmaceutical supplies as an incident to their visit to a private physician, rather than as an incident to their use of hospital facilities.

    * IRS's current definition of "patient," if consistently and diligently applied, provides clarity for the taxpayer and adequate control for the IRS.

3. The sale or lease of durable medical equipment to patients should remain tax-exempt for the same reasons that the present law convenience exception should stand.

    * Provision of durable medical equipment to patients is an essential part of health care delivery.

    * Sales to members of the general public or physician's private patients are not sales to patients and such sales are taxable under current rules.

    * IRS's current position that sets forth the circumstances that must exist to avoid the imposition of tax is workable and should be retained.

Thank you for your attention to this request. Hopefully your Oversight Subcommittee will not recommend changes in the unrelated business income tax rules.

Sincerely,

Jim Gasper
Director of Government Reporting
Memorial Care System
(713) 776-6971

MESTON
VACATION WORLD
Since 1963

April 14, 1988

The Honorable J. J. Pickle
242 Cannon House Office Building
Washington, DC 20515-4310

Dear Congressman Pickle:

It's great to have a fellow Texan devote so much time in assisting people like us, a for profit tour business, to overcome the problems we have been facing through unfair competition. You and your Ways and Means Subcommittee on Oversight are to be commended.

I understand the committee is considering discussion options to address the unfair competition. All of these represent important steps in the right direction. One particularly significant option is to apply the Unrelated Business Income Tax (UBIT) to certain specified activities, including tour and travel services. These activities are commercial in nature. Therefore, if a tax exempt organization engages in these, they should be treated as taxable activities. This is an extremely FAIR approach in that it provides an equitable and consistent method of addressing commercial activity, regardless of the type of organization carrying out that activity.

I encourage you to support the options now being considered by the Subcommittee. In doing so, you will be striking a blow for fairness in the marketplace and you will be providing a great service to countless struggling small businesses across America.

Sincerely,

Harvey Meston

Harvey Meston, CTP

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ASTA ARTA

Larry L. Mathis
President
Chief Executive Officer

Methodist

The
Methodist
Hospital
System

6565 Fannin
Houston, Texas 77030
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April 15, 1988

HAND DELIVERED

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

Pursuant to a press release dated March 31, 1988, comments from the public were solicited with respect to various options to be considered by the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives (the "Subcommittee"), in connection with possible revisions to the current unrelated business income tax ("UBIT") provisions of the Internal Revenue Code of 1986. Those options are a follow-up to the hearings held by the Subcommittee last summer. In response to that request, The Methodist Hospital System, Houston, Texas ("Methodist System"), and its affiliated exempt and non-exempt organizations, hereby respectfully submit comments on certain of the options presented in the press release.

Included in the group of affiliated non-profit and business corporations comprising the Methodist System is The Methodist Hospital ("Methodist Hospital"), one of the largest tertiary-care hospitals in the United States. Both the Methodist System and the Methodist Hospital are organizations described in section 501(c)(3) of the Internal Revenue Code of 1986 (hereinafter all section references are to the Code) and are other than a private foundation within the meaning of section 509(a).

Before setting forth the comments of the Methodist System, it must be emphasized that the Methodist System agrees with the statement of the Honorable O. Donaldson Chapoton, Deputy Assistant Secretary (Tax Policy), Department of the Treasury, that additional information regarding the administration of the current law is a prerequisite to meaningful modifications to the existing UBIT provisions of the Code. 1/ It appears that the non-exempt organizations calling for changes to the UBIT provisions are in large part basing their calls on assertions of unfair competition. However, those organizations have not provided meaningful data against which to measure those assertions. It would

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1/ Statement of O. Donaldson Chapoton, Deputy Assistant Secretary (Tax Policy), Department of the Treasury, before the Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives (June 22, 1987) (hereinafter cited as "Chapoton Statement") p. 3.

appear necessary to have data which establishes that the claimed "unfair competition" is harmful to the general public, and especially those individuals who receive the services or products of such "unfair competition," before any meaningful changes to the current system can be made. Certainly, we do not believe that changes to an existing system should be made without a showing that such changes will result in greater benefit to the general public as a whole. It may also be surmised that many of those who are alleging "unfair competition" are not seeking competition which is "fair," but rather seeking the elimination of any competition from the exempt sector.

It is also noted that most of the alleged "unfair competition" allegedly experienced by certain non-exempt businesses appears to occur in activities unrelated to, and outside of, the health care field. With that in mind, the Subcommittee is respectfully urged to consider carefully the broad effects of proposals intended to remedy specific abuses, particularly where those unintended effects impact a health care industry already facing declining revenues, including Medicare and Medicaid program funding cuts, and escalating costs while still attempting to maintain the highest possible quality of care for the people in need of the industry's services.

With respect to developing meaningful information, it is noted that the Internal Revenue Service (the "IRS") is currently conducting a taxpayer compliance maintenance program ("TCMP") in order to gather additional information regarding the current application of the UBIT provisions. The Methodist System respectfully urges the Subcommittee to delay any action modifying the UBIT provisions until the results of the TCMP can be analyzed.

I. The "Substantially Related" Test 2/

In general, income derived from activities which are "substantially related" to the charitable purpose or purposes of an exempt organization are not subject to UBIT. In the case of tax-exempt hospitals, the relevant charitable purpose is the provision of health care to patients on both an inpatient and outpatient basis. Thus, activities which are substantially related to that purpose are not currently subject to UBIT. The three alternatives to the current "substantially related" test set forth in the press release are: (A) replace the "substantially related" test with a "directly related test," (B) require a determination whether each income-producing activity standing alone is tax-exempt or (C) retain the "substantially related" test, but tax the income derived from specific activities deemed inherently commercial.

2/ The comments set forth herein with respect to certain of the options listed in the press release bear the same numbers and captions as used in the press release.

A. "Directly Related" Test

Although an explanation of the particulars has not been found, it is assumed that the "directly related" test will require a greater degree of relationship than the "substantially related" test. It is not clear, however, whether a "directly related" test will afford any more certainty or "fairness" than the "substantially related" test as either test will depend upon subjective factors. However, the "substantially related" test, although far from perfect, has been with us for a long period of time and has proved to be relatively effective in keeping exempt organizations from engaging in businesses which do not contribute to the ability of the exempt organization to fulfill its exempt objectives. The "directly related" test, on the other hand, is currently undefined. The confusion and uncertainty resulting from a change in tests would appear to far outweigh any perceived benefit, especially when the perceived benefit in all likelihood would be based on speculation as opposed to meaningful statistical data.

B. Stand Alone Analysis

The second alternative to the present "substantially related" test is an individual analysis of each income producing activity conducted by an exempt organization to see if each such activity, standing alone, is tax-exempt. This stand alone test would represent a drastic departure from current law and would severely reduce the revenues otherwise available to exempt organizations to be used in the conduct of their exempt purposes. That effect in the health care area can be illustrated by a few examples.

A clear example of the undesirable negative effect of the stand alone test in the health care area is patient, employee and visitor support activities, such as parking, gift shops and cafeterias. 3/ Each of those activities contributes importantly to the provision of quality health care (both on a direct and indirect basis) by a hospital, but standing alone, each of those activities is not tax-exempt. There are certainly other activities which are usually viewed as exempt, but when analyzed under the stand alone test would not be so viewed because the class of beneficiaries being served is deemed to be small. Thus, the revenue derived by an exempt hospital from those activities, which is currently available to support (1) non-revenue producing exempt activities, (2) the below cost provision of certain health care services, (3) the provision of free health care services to certain patients and (4) most importantly, the provision of quality health care, would be taxed under the stand alone test.

It should be emphasized that in the health care area, adoption of the stand alone test would promote nothing but the above-described reduction of revenues available to

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3/ *See* discussion under "Convenience Exception," *infra*. If the convenience exception is not deleted, which deletion is proposed in the press release, some of the activities otherwise subject to UBIT under a stand alone analysis would fall under the convenience exception.

exempt hospitals for charitable activities. That is true because the traditional patient, employee and visitor support activities which would become subject to tax can only be adequately provided on an on-premises basis by the health care institutions involved. Thus, the stand alone UBIT approach reduces revenues otherwise available for charitable health care activities while providing no corresponding benefit, such as enhanced competition for commercial enterprises, because the activities involved are of a type which cannot be provided by entities other than the specific health care institutions. Also, if the intent of changes to the present UBIT provisions is to cause exempt organizations to allow commercial enterprises to conduct activities presently being conducted by the exempt organizations, the changes could cause an exempt organization (such as Methodist Hospital) to lose control of activities related to the accomplishment of its exempt purposes. If commercial enterprises were allowed to take control of patient, visitor and employee support services, it is possible that the quality of those services could suffer and that the emphasis could shift away from patient, visitor and employee support to an emphasis on commercial success.

Based on the foregoing discussion, it is apparent that, in the health care context, the stand alone test would cause a reduction in revenues which traditionally have been available to support related, charitable activities. If imposed, the stand alone test will mandate either an increase in patient charges or a reduction in health care services. In light of such negative results, it is suggested that the stand alone test be eliminated from consideration as an alternative to the "substantially related" test.

C. Tax Inherently Commercial Activities

The third proposal to modify the "substantially related test" set forth in the press release introduces into the existing UBIT structure a list of inherently commercial activities the revenues from which would be subject to tax. It is not clear whether the listed activities are the only activities which would be treated as "inherently commercial" or whether the list is merely representative of "inherently commercial" activities. If the latter view is correct, it is submitted that by the time the legislative process is completed, the list will be significantly longer. While we advocate retention of the "substantially related" test and the continued taxation of unrelated commercial activities, we are nonetheless concerned over the use of an exhaustive list of "inherently commercial" activities which materially alters the substantially related concept.

For example, the proposal set forth in the press release would subject revenues derived from gift shops/bookstores to UBIT unless the articles sold are used by or for inpatients. Obviously, it is not possible for a hospital gift shop clerk to know whether each purchase is or is not being made for an inpatient without requiring each customer to be surveyed. It is similarly impossible for an all inclusive list of "approved" articles required by inpatients to be developed. Thus, to impose an inpatient/outpatient UBIT test to hospital gift shops appears highly unworkable, particularly in view of the fact that on-premises sales of merchandise by hospital gift shops do not appear to pose a competitive threat to any other business. Moreover, such a test loses sight of the fact that outpatients are just as much patients of a hospital, and thus in need of patient support activities, as inpatients. Hence, it seems incongruous to limit excepted sales to inpatients when there is an increasing trend towards, and demand for, outpatient procedures. Outpatients as well as their families, particularly outpatient surgery patients who may be present at the hospital for twelve hours or more, have certain needs which can be most effectively met by shops located in the hospital in which the outpatient procedure is performed. It would be illogical to assert that such needs be met elsewhere unless the hospital incurs another layer of costs, recordkeeping and reporting resulting from the sales of gift shop items being taxable. 4/

The proposals relating to medical equipment sales or rentals are also troublesome. While it is undisputed that casual sales or rentals to persons who have no existing, nor develop any, patient relationships with a health care institution should be subject to UBIT, it is not entirely clear that the suggested modification addresses only those situations. In light of the problems which might be caused in the medical equipment area by enactment of the proposal set forth in the press release, an alternate approach based on the patient concept is suggested. The IRS has defined several categories of patients, and such categories could be used in situations such as sales and rentals of medical equipment. 5/ Sales and rentals of medical equipment to persons who do not fall within the defined patient categories would be subject to UBIT while sales and rentals to patients would not be so subject.

The proposal with respect to application of UBIT to "certain health, fitness, exercise and similar activities" is another limitation which should not be extended to exempt hospitals (such as Methodist Hospital) which conduct such activities as an important part of their overall health care program. Such "health, fitness, exercise and similar activities" are important from both a preventive medicine and rehabilitative medicine viewpoint and thus contribute importantly to the promotion of health. It should be noted that these activities, as conducted by an exempt hospital, are usually conducted or supervised by health care professionals (such as nurses or physical therapists) in accordance with programs developed by staff physicians.

Another area on the inherently commercial activity list which causes concern is the routine testing area. It should be noted that the provision of quality health care and the development of new health care procedures and/or equipment often involves repetitious activities which may be

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4/ This appears particularly true in the case of hospital gift shops which are often run by volunteers and the proceeds of which are used to support charitable activities undertaken by such volunteers.

5/ It is respectfully suggested that the patient concept could be used to address a number of the UBIT issues developing in the health care area.

mistakenly classified as routine testing. For example, cancer and transplant patients undergo extended post operative testing procedures which are crucial to their treatment, which testing is routine only in its repetitive nature. Thus, it is suggested that any modifications to the application of UBIT to testing activities clarify that testing which is mandatory to patient care, accompanies medical research 6/ or is undertaken as part of medical education is neither routine nor subject to UBIT.

D. Summary

With respect to the substantially related test, the Methodist System and the Methodist Hospital agree that "the standard, as interpreted by the regulations, has conceptual merit." 7/ Thus, any drastic revision such as the adoption of a directly related test or a stand alone UBIT analysis is strongly opposed. Moreover, implementation of broad, general changes to address yet to be identified narrow abuses is opposed. In the context of the proposals set forth in the press release, it is believed that retention of the substantially related test with some modification for specific activities may be a workable proposal. However, it is again urged that any proposals be withheld until the results of the TCMP currently underway can be analyzed.

II. Convenience Exception

Under current law, tax-exempt organizations are not subject to UBIT with respect to revenues received from activities which are carried on primarily for the convenience of, among others, patients, visitors or employees (i.e., the "convenience exception"). In the health care setting, this exception has been relied on to exempt from UBIT revenues received from parking, gift shops, cafeterias and other support services. 8/ As is discussed above under the stand alone test alternative to the substantially related test, imposition of UBIT on the activities just described serves no purpose other than to reduce the revenues available to exempt organizations to be used in pursuit of their charitable activities. Thus, any modification to the existing convenience exception should be made only with a corresponding clarification of the substantially related test (or any alternative thereto) whereby it is made clear that traditional patient, employee and visitor support activities are an extremely important part of the

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6/ See Treas. Reg. §170A-9(c)(2)(iii) for the definition of medical research.

7/ See Chapoton Statement p. 19.

8/ Note that these activities are also discussed in connection with the substantially related test above. It is not clear under current law whether the proper analysis for such activities is under the substantially related test or the convenience exception. At least one government spokesman has suggested that these activities are not subject to UBIT as a result of being substantially related to the tax-exempt organization's charitable purposes. See Chapoton Statement p. 22.

accomplishment of the charitable purposes of exempt health care institutions and will not be subject to UBIT.

IV. Tax Treatment of Royalty Income

Currently, income received by way of royalty payments is not subject to UBIT unless such payments are debt-financed. The press release describes a proposal whereby UBIT would be applied to royalties measured by net or taxable income derived from property or received for use of property if the receiving organization, or a closely-related organization, either created such property or performed substantial services or incurred substantial costs with respect to the development or marketing of such property. Although a revision of the UBIT royalty provisions, which emphasizes the exemption of passive income and eliminates the marketing of trade names and goodwill, may be desirable, the suggested proposal could have broad, undesirable effects in the health care area.

In the past, the development of new medical equipment and technology has often occurred in partnerships or joint ventures involving exempt health care institutions and, in some cases, commercial enterprises. The exempt health care institutions have traditionally contributed substantial sums of money, property or both in the development phase of these ventures and then recouped such costs through royalty income received upon the successful marketing of the new device or technology. Under the proposal set forth in the press release, some of such royalty income would be subject to UBIT.

It is believed that the imposition of taxes on the foregoing method of developing new medical technology and equipment would have a material, adverse impact on the advancement of medical knowledge and the improvement of health care quality since a significant source of recoupment of development and research costs would be eliminated or, at the very least, diminished. Recognizing that exempt health care institutions perform a major part of the medical research undertaken today, it seems ill-advised to restrict the manner in which such institutions may participate in the active development of new medical technology and equipment.

VII. Subsidiaries and Joint Ventures

A. Minimum Income of Taxable Subsidiaries

The press release sets forth a proposal which would modify existing law and require a taxable subsidiary of a tax-exempt organization to recognize income at least equal to the income which, if the income generating activity were conducted by the tax-exempt parent, would be subject to UBIT. To the extent this proposal is designed to prevent loss generating activities from being offset against income producing activities in taxable subsidiaries of tax-exempt organizations, it is nothing more than an attempt to artificially inflate the income of a tax-exempt organization or its affiliates subject to tax. Moreover, it does not appear that competition is "promoted" by not allowing such offset by businesses owned by tax-exempt organizations but continuing to allow other businesses to so offset.

B. Aggregation of Activities

Under current law, the exempt status of an organization is determined solely with respect to the activities undertaken, directly or indirectly, by such organization. As a result, the activities of a wholly-owned, for-profit subsidiary of an exempt organization are analyzed separately from the activities of the exempt parent organization unless such activities are appropriately deemed carried on, directly or indirectly, by such exempt parent organization. The press release contains a proposal which would aggregate the income and activities of a controlled subsidiary with the income and activities of its exempt parent organization for purposes of determining whether the exempt parent organization is tax-exempt, regardless of whether it is appropriate to view such activities as having been carried on, directly or indirectly, by such exempt parent organization.

The formation of a business subsidiary by an exempt organization in which to place unrelated business activities is clearly encouraged by, and serves to fulfill the policy underlying, current law in the UBIT area. The business subsidiary is taxed on its income from the unrelated activities and any after-tax dividends paid to the exempt parent are not subject to UBIT unless the acquisition of the business subsidiary was debt-financed. The result is the same as that which occurs in the case of an exempt organization holding a minority interest in a corporation.

However, in order to correct perceived abuses, the proposal set forth in the press release suggests that the separate existence of an exempt parent organization and a business subsidiary corporation, more than 50 percent of which is owned by the exempt parent organization, be ignored and the activities of the corporations be considered together in order to determine whether the parent organization is entitled to exemption. It is believed that the abuses sought to be corrected by the aggregation approach (i.e., the conversion of income subject to UBIT into exempt income while maintaining the deductibility of expenses incurred in the production of such income) are better addressed by more narrowly drafted proposals. For example, the proposal relating to royalty income appears to address part of the foregoing concern as does the lowering of the control threshold to 50 percent. Thus, it is suggested that enactment of the aggregation approach to determine a parent organization's exempt status is overly broad and that more narrowly focused provisions are available with which to correct perceived abuses.

VIII. Allocation Rules

In determining the income from the conduct of an unrelated trade or business by a tax-exempt organization, current law provides for a deduction for expenses which are directly connected with the carrying on of such trade or business. Included in costs and expenses which are directly connected with the carrying on of an unrelated trade or business are direct operating costs, general overhead and depreciation expenses. The press release sets forth a proposal which would disallow a deduction for general overhead and depreciation expenses.

While it can be argued that certain overhead expenses and depreciation expenses incurred by exempt organizations to support their exempt activities will be present regardless of the conduct of any unrelated trades or businesses, denying a deduction for such expenses properly allocable to an unrelated trade or business is contrary to the most basic principles relevant to the computation of income from a particular activity. In order to properly compute the income derived from a particular activity, it is necessary to consider all expenses, including overhead and depreciation. Otherwise, the income derived from the activity is overstated. While it cannot be denied that exempt organizations should not be given a competitive advantage over commercial enterprises with respect to the conduct of an unrelated trade or business, it is equally clear that exempt organizations engaged in an unrelated trade or business should not be made to pay more tax than a commercial enterprise in the same situation by artificially increasing their income. To do so is to penalize an exempt organization for the conduct of charitable activities. 9/

In closing, the Methodist System agrees with the Subcommittee's efforts to curb abuses in the UBIT area. However, the Methodist System would emphasize that the full impact of provisions designed to address specific problems must be considered so that legitimate activities are not adversely impacted thereby. In particular, care should be taken to allow tax-exempt health care institutions to continue (1) traditional patient, visitor and employee support activities, (2) the development of innovative treatments on an outpatient basis and (3) developing new technologies and procedures either independently or in joint ventures.

Sincerely,

Larry L. Mathis
President
Chief Executive Officer
The Methodist Hospital System

9/ Resolution of this issue may be aided by the results of the TCMP currently underway by the IRS.

COMMENTS ON UBIT DISCUSSION OPTIONS
SUBMITTED BY WILLIAM H. LUERS,
PRESIDENT OF THE METROPOLITAN MUSEUM OF ART

On behalf of The Metropolitan Museum of Art, I am writing to convey comments on the Subcommittee on Oversight's preliminary discussion options regarding the unrelated business income tax (UBIT).

The basic structure of the UBIT —based on the "substantially related" test— is, we believe, a sound one. It is consistent with the exemption from federal income tax, which from the earliest days of our federal tax system has been accorded to entities organized and operated exclusively for charitable and educational purposes. It reflects a recognition on the part of our government that the income generated by the activities of charitable and educational organizations should be free from taxation, so long as these activities are carried out in furtherance of their exempt purposes and thus fulfill an important public function.

We are troubled by a number of the options under consideration by the Oversight Subcommittee. I will focus, however, on the option which causes us the deepest concern and note for the record this Museum's agreement with the comments on this and other options submitted on behalf of the Association of Art Museum Directors.

Most troubling to this Museum is the option regarding gift shops and bookstores, which would extend the UBIT to "off-premises sales" regardless of whether such sales furthered the exempt purposes of the organization making them. We believe this would constitute a significant and unwarranted change in the basic structure of the UBIT and that its inclusion in the list of options may be based on a misunderstanding of the purposes of "off-premises sales" and a misperception of them as "inherently commercial." To shed light on this important issue, I believe it would be helpful to share our experience at the Metropolitan Museum in this area, and more particularly to explain the philosophy behind our publications and reproductions* program, as well as the way in which it functions, which makes it fundamentally different from a commercial operation. But first I want to say a word about our sources of support at the Museum and the effect of placing further limitations on those sources, which would be deleterious for cultural institutions in general and museums in particular.

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*In these comments, the word "reproductions" is intended to include exact replicas as well as adaptations that incorporate and convey meaningful information about the designs of original art objects.

Sources of Support

It is well known that federal and other government funding of nonprofit organizations has failed to keep pace with rising costs. With the recent reductions in the tax incentives to make charitable contributions of appreciated property, we cannot expect funding from the private sector to fill the gap. We must instead look increasingly to income earned from related activities to help us make ends meet. At the Metropolitan Museum, the proportionate contribution to operating income made by revenues from merchandise sales has grown steadily over the past decade, as has the Museum's dependence on these revenues.

In recent years, the Museum has either operated at a deficit or avoided a deficit by the barest of margins. If it is to continue to fulfill its fundamental educational mission effectively, by, for example, keeping galleries open on a daily basis and continuing to subsidize scholarly publications, the Museum must be able to rely on the full extent of its income earned from related activities. To tax that income would cut into one of the few remaining resources available to us to keep up with rising costs, and it would do so without achieving significant revenue gain for the government.

Philosophy of the Program

The Museum's charter granted in 1870 provides that the Museum was founded:

> ...for the purpose of establishing and maintaining... a Museum and library of art, of encouraging and developing the study of the fine arts, and the application of arts to manufacture and practical life, of advancing the general knowledge of kindred subjects, and, to that end, of furnishing popular instruction.

From the founding of the Museum onward, publications and reproductions have played an important role in the Museum's educational and outreach effort. In their second annual report the Trustees of the Museum wrote:

> There is one part of the business of a great Museum which has only of late been recognized as it ought to be by even the museums of Europe, namely, the publication of reproductions or copies of its own treasures of art, whether for exchange with other museums for similar publications of theirs, or for sale to the public. This is obviously an important duty, and affords a powerful means of imparting instruction.

In 1870, before the doors of the Museum itself opened, the Trustees had commissioned a series of engravings of works on the collection. These engravings were offered for sale, both within and outside the Museum. They were designed to acquaint the public with the new institution and in 1871 they were advertised as far afield as London. There was at that time, and there remains today, a vast audience which has never visited a museum and may never do so. The distinguished French art historian, Andre Malraux, has described the vital function of publications and reproductions as an effective means of communicating the message of works of art to the audience unable to visit museums.

The continuing growth of the Museum's publications and reproductions activity is outlined in the booklet, The Publications and Reproductions Program of The Metropolitan Museum of Art: A Brief History, which was published in 1981. The Museum is a member of the Association of American University Presses, and the books issued by its publications service range from scholarly publications and archaeological expedition reports to popular exhibition catalogues and introductory volumes to various areas of the collections. The Museum has received numerous awards recognizing both the high level of scholarship of its publications and the excellence of their production. In a recent review the museum community as a whole was cited as one of the last bastions of serious art history publishing.

It is worth noting that by the 1890's the Museum was maintaining an active reproduction workshop producing copies of several hundred different works of art. By 1921, as part of its continuing effort to extend knowledge of the collections beyond its walls, the Museum was issuing annual mail order catalogues.

Today, copies of works of art and archeology originated by museums are conveying with increasing accuracy the message of the originals. At the Museum, a cast stone copy of an ancient Egyptian limestone relief was placed on exhibition (appropriately labelled) when the original was on loan to another institution. In view of the significant advances in the technology of reproduction in recent years, reproductions which are issued with an informative descriptive text can provide a valuable educational service and those who buy them have an opportunity to further their knowledge of the Museum's collections.

If it is appropriate to offer publications and reproductions within the Museum, it is possibly an even more pressing responsibility to make them known and available to the larger audience outside the Museum. Mail order and off-premises sales are one of the most effective means of meeting this responsibility. Like the reproductions themselves, the mail order catalogues include descriptive, informational text on the items offered for sale. In addition to expanding the public's knowledge of the collections mail order and other off-premise sales encourage people to visit the Museum. In this way, these sales help the Museum in its outreach efforts.

Functioning of the Program

The Metropolitan Museum is in the unique position of acting as the publisher and producer of its own publications and reproductions. The process by which the publications and reproductions program operates is quite different from the operation of a commercial merchandise program. While our sales methods (involving, for example, mail order catalogues) may appear to overlap with those of for-profit retail businesses, no part of this program could accurately be described as "inherently commercial." As stated above, it is fundamentally motivated by the Museum's educational mission rather than by the desire to generate revenue. This important distinction extends to the very way in which publications and reproductions are conceived and manufactured, and it characterizes the functioning of the publications and reproductions program at every step.

For example, the preparation of scholarly manuscripts for publication requires a close daily working relationship among the curatorial staff, designer, photographer, and editor. In the same manner the reproduction of an object in the collections requires the closest cooperation between the Museum's curatorial and technical staff.

The initial selection of a work of art for reproduction and the approval of the final results of the reproduction process require specialized knowledge, including the ability to judge the stability of the original and its tolerance to various processes. In addition, frequent access to the original may be necessary to maintain the highest level of quality. The examination and physical handling of an object during the reproduction process requires technical skills which cannot be delegated to non-staff personnel.

As The Publications and Reproduction Programs of The Metropolitan Museum of Art: A Brief History notes, the Museum's search for maximum quality led to the establishment of a full scale printing establishment within the Museum and the design of special type faces. Today, a reproduction studio continues to be maintained in the heart of the main building of the Museum, and a staff of specialized technicians and craftspeople are employed to carry out the molding and reproduction activity. Where necessary, the studios are supplemented by outside sources which employ master models and other technical data developed by the Museum.

A result of this necessarily specialized approach to publishing and reproduction is that more than eighty-five per cent of the Museum's sales revenue comes from publications and reproductions produced by the Museum itself or produced exclusively for the Museum under the Museum's direction.

There are other areas in which our publications and reproductions program differs from that of a commercial publisher or producer. Specifically, the range of subject matter produced by the Museum would not appeal to a commercial publisher or producer. Indeed, it is fair to say that if the Museum did not undertake to produce this subject matter, probably no commerical entity would, and a whole range of educational products would not be issued at all. In addition, the inventory levels which the Museum carries are more burdensome than those which are acceptable in the commercial sector.

The continuing search for outside craft and manufacturing sources willing to meet the Museum's requirements is a major task. As a rule, manufacturers find the Museum's specifications too onerous and time consuming. Maximum fidelity to a design concept frequently does not match contemporary manufacturing techniques. Two years is not an uncommon span for the development of a single reproduction. It took the Museum almost a decade to find a glasshouse willing to make its reproductions. The Museum's original supplier of silver reproductions gave up on Museum manufacturing as "too demanding" in view of other more profitable business. Even the Museum's greeting cards are produced in non-standard sizes in order to accommodate the dimensions of the design rather than the press size.

Because it is driven by an educational mission, the Museum's publications and reproductions program is a costly one. The sales volume generated by our mail order and off-premises outreach efforts makes it feasible to produce both publications and three-dimensional reproductions in quantities which would not be practical if the circulation of these products were limited to sales on the Museum's premises only. This is particularly true for products employing full color printing or products requiring tools or dies. In both cases the Museum must be able to distribute a minimum quantity of these products in order to make their production feasible at all. In absence of mail order and off-premises distribution, unit production costs would become prohibitive. Thus taxation of off-premises sales could curtail a major informational and education outreach effort.

In sum, the publications and reproduction services which we provide to the public can only be provided by the Museum. No commercial entity is prepared, equipped or even willing to assume this responsibility. That the commercial sector recognizes this is demonstrated by the absence of complaints from that sector about our sales activities. Advertising and mail order are essential if the Museum is to make its publications and reproductions accessible --by virtue of both affordable prices and availability-- to the widest possible audience.

Conclusion

Everyone would, I believe, agree that the dramatic growth in quality and number of museums in America over the last forty years has permanently altered and improved the cultural life of this country. Museums play a crucial role in preserving and displaying our common heritage, and it would be a most regrettable change in government policy to tax one of the important activities that helps museums to carry out their educational mission fully and effectively.

michigan vma

April 11, 1988

Honorable J. J. Pickle
U. S. House of Representatives
Washington, DC 20515

Dear Congressman Pickle:

This letter is in response to the request from the House Ways and Means Subcommittee on Oversight to comment on the options, presented in their March 31 press release, regarding unrelated business income tax (UBIT) on non-profit organizations. These comments will be limited to veterinary services provided to the general public by tax-exempt humane societies.

UBIT is not the appropriate answer to solving the problem of unfair competition between tax-exempt, charitable non-profits and taxpaying for-profit small businesses. The monies required to pay the tax would only be taken from those funds designated for charitable purposes and further the non-profit's need for income through "profit making" activities. As identified in the 1986 White House Conference on Small Business, the issue is preventing economic damage to the small business community through unfair competition, not how to increase taxation of non-profits.

A more appropriate and effective approach would be to require all directly competing businesses to operate under the same tax laws. The charitable, non-profit tax laws were created to allow certain entities to more economically supply goods and services to people in financial need, not to be more effective as a business competitor in the sale of products or services. We hope your committee will consider requiring all veterinary hospitals, that are involved in the sale of veterinary services to the general public, excluding those involved as teaching hospitals, be required to operate as "for profit" entities. Veterinary hospitals limiting their services to stray animals or those owned by indigents, or to spaying and neutering procedures could still be exempted with no further tax liability.

Regarding the options presented in the press release, the "substantially related test" (I. F.) states that UBIT should be applied to certain veterinary services such as grooming, boarding and elective surgery, excluding all others as they are either directly related to animal health or to public health. Grooming and boarding should not even be considered veterinary services and therefore no need to consider them as UBIT exclusion, no more than barbering and motels are considered human medical services. As for elective surgery, probably 95% of that is spaying and neutering, which is being excluded. With nearly 100% of actual veterinary services excluded from UBIT, this recommendation will do absolutely nothing to alter the competition issue.

-more-

Michigan Veterinary Medical Association
1405 South Harrison Road, Suite 11
East Lansing, MI 48823
(517) 332-2913

Peter A. Prescott, D.V.M.
Executive Director

If the Subcommittee will not recommend prohibiting tax-exempt non-profits from continuing to operate businesses that are advantaged from both a financial and promotional standpoint, then this alternative to UBIT should be considered.

If fees for veterinary services are to be non-taxable and directly related to charitable purposes of tax-exempt organizations, then it should follow that these same fees should also be considered a charitable contribution for the taxpaying pet owner. Why not allow clients of tax-paying veterinary hospitals to deduct these same veterinary service fees on their federal tax return under charitable contributions? This would help neutralize the financial advantages the non-profit receives without penalizing them through additional taxation. In addition, animals would benefit as their owners would be more likely to seek veterinary care if it were tax deductible. The for-profit business would continue to pay taxes and would receive no benefit, other than being able to more fairly compete with tax-exempt hospitals.

We appreciate your efforts in tackling a very difficult problem. Regardless of where veterinarians elect to earn a living, their objectives are the same, to provide a public service by caring for the health needs of animals. To penalize those who accomplish this by investing their own money in their endeavor is unfair competition and detrimental to the development of small business.

Thank you.

Sincerely,

P. A. Prescott, DVM
Executive Director

MICRO ANALYTICAL
LABORATORIES, INC

April 13, 1988

Mr. Robert J. Leonard, Chief Counsel
U. S. House of Representatives
Oversight Subcommittee of the House Ways and Means
Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Subject: Proposals in the U.S. House of Representatives to curb nonprofit competition

Dear Mr. Leonard

As a member of the small business community here in Gainesville, Florida, Micro Analytical Laboratories is acutely aware of the problems posed by nonprofit competition. With the close proximity of the University of Florida, many jobs that would otherwise go to small laboratories, go to the University instead because they can offer lower prices. A small business has a capital investment with interest to pay on borrowed money. If his accounts receivable don't come in on time he has to borrow against them and again pay interest.

Nonprofit organizations have no taxes to pay to speak of including sales tax on equipment or materials needed for testing.We are facing competition from hospitals, universities and other nonprofit organizations for which overhead, advertising and maintenance costs are hidden or at a miniumun cost because they're spread out among other areas. In universities, labor costs are less than the market place because graduate students are used and the pay scale is lower.Competition is fierce in the market place, but when nonprofit organizations cut prices from 30% to 50% the survival rate of a small business is frightening.

The biggest inequity of all is when the nonprofits use tax savings to pay high salaries to their executives and subsidize their perks.Most businesses in the United States started on a small scale and some grew to become giant companies. It's about time that small businesses get some tax advantages so that they may expand and not fail. We need our investment credits among other things.

We are at the mercy of self serving interests. Don't take away our American dream or our initiative as we need to regain what was lost to foreign competition.I believe that common sense should prevail and not some lobbyist's fat contribution when these decisions are made. It appears that the taxpayer in this instance is again the scapegoat as he is subsidizing those who need it the least.

Sincerely yours,

Robert A. Longo
President/CEO

RAL/ed
Enclosures

ONE MANHATTAN SQUARE ROCHESTER, NEW YORK 14607 TELEPHONE: 716 263 2700

THE
STRONG
MUSEUM

April 12, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

As President of the Mid-Atlantic Association of Museums with over 1300 individual and institutional members, I urge the Ways and Means Oversight Sub-Committee to understand the plight of museums in this country. We often hear individuals express delight in, or abscribe importance to, our cultural legacy. Yet support of those organizations which safeguard and promote that legacy is constantly being eroded. Our small museums and historical societies often receive little or no direct Federal support. They help keep their doors open through the utilization of monies received from such sources as shop sales and tour receipts.

But, be they large or small, these cultural institutions hold a precious legacy...ours. We must do all we can to keep them healthy. By understanding their value I would hope that the Sub-Committee would avoid endorsing any legislation which would add burdens to our cultural organizations or, in any way, be detrimental to their existance.

Sincerely,

Lynne F. Poirier
Vice President for Collections
The Strong Museum
President
Mid-Atlantic Association of Museums

cc: Congresswoman Louise M. Slaughter

Beltone®
Better Hearing Through Professional Care

Middle Tennessee Hearing
Aid Center, Inc.
102 Blythewood Drive
Columbia, TN 38401

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing in response to a letter I received about a reform of the Unrelated Business Income Tax (UBIT) system that applies to nonprofit organizations. I appreciate the subcommittee allowing me to express my opinions concerning these measures. I write to you with great concern about commercial hearing aid sales by nonprofit organizations.

In this business I have noticed the nonprofit competition effecting me more and more and find it increasingly difficult to compete against.

I feel that this is not fair business practice for one business to pay federal, state and local taxes and for another to be exempt from these taxes, when they are both involved in the same business. I also don't feel it is fair when a nonprofit organization can get exposure on television, radio and newspaper via donated time and space. I find myself faced with the nonprofit receiving charitable donations from such organizations as United Way, Christmas Village, community yard sales, University inter-squad football games (Vanderbilt) among others.

These nonprofits are competing for the same business that I as a small businessman (paying taxes that fund such organizations) am competing for.

To top it off, they sell their hearing aids at lower prices and have access to state of the art equipment which a private individual business would love to afford. I am often faced with people checking prices and trying to get the best deal. I don't fault the people who do this as I would do so myself. When they state that they can get cheaper prices at a nonprofit center, I feel that all my time and effort is wasted. In all fairness to some nonprofit organizations, I do feel that they provide a needed service. But I feel that they should go by the same rules that a paying small businessman must meet.

Sincerely,
Daniel W. West
Daniel W.West, M.Ed.

DWW/pv

MIDWESTERN UNIVERSITIES ALLIANCE
400 SOUTH CAPITOL STREET, S.W. — 110
WASHINGTON, D.C. 20003
(202) 554-7863

Indiana University
University of Minnesota
University of Missouri
The Ohio State University
Purdue University
University of Wisconsin

April 15, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
1105 Longworth House Office Building
Washington, D.C. 20515-6350

Dear Mr. Chairman:

In behalf of the members of the Midwestern Universities Alliance, I want to thank you for this opportunity to respond to the preliminary discussion options on the unrelated business income tax that were released last March 31st by the Subcommittee on Oversight. In addition, let me thank you and the staff of the Subcommittee, both majority and minority, for the open manner in which the review of UBIT has been undertaken. I and my colleagues in higher education have had ample opportunity to present our views and for that we are grateful.

From the beginning of the Subcommittee's review process, we, the Midwestern Universities Alliance, have worked closely with the American Council on Education. We helped the Council develop its position and we subscribe to the stand that it has taken on the Subcommittee's discussion options. We want to underline particularly ACE's comments on the royalty exception. One of the principal activities of major state universities is to support the economic development of their states and local communities. If the incentives for transferring technology to companies in our states are reduced because of a new tax liability, our institutions will be less effective in their economic development activities than they are at present.

With respect to research and testing, the members of the Midwestern Universities Alliance are pleased that the Subcommittee did not choose to eliminate or change the research exception. As we have stated before, it is the conduct of basic and applied research that enables our institutions to serve their state farmers and state businesses both small and large. The Subcommittee action, or inaction, preserves vitally important activities of our institutions.

With respect to testing, we agree with the changes made by the Subcommittee. The exemption for state and federal mandates is important as is the exception for testing that supports the education of students. We hope, however, that the Subcommittee will 1) clarify the term "mandate" as it is used in the phrase "federal or state mandated activities..."; 2) exempt testing that is conducted in order to obtain data for ongoing research projects; 3) exempt testing that is conducted in order to obtain data for data bases that are currently in use; and 4) exempt testing that enables our institutions to transfer research findings to farmers and businesses.

Federal or State Mandates. The term "mandate" should refer to both statutory requirements and contractural agreements. Under that definition, testing would be exempt if it is mandated either by statute or by contract. About half the states have laws requiring their land-grant universities to conduct soil tests. (In the other half of the states, incidentally, soil testing is conducted without a mandate.) But many states contract with our institutions to conduct certain tests. Cornell, for example has a contract with the state of New York to test horses that race on New York race tracks; there is, however, no state law requiring the university to do so.

Research. We agree with ACE's proposal which says, "We believe, however, that if a provision on testing is included in the statute it should specify that any testing activities incident to a research project would fall under the research exception." Our colleges of agriculture conduct tests that provide important data for the institution's research programs. At the end of this letter, we will give illustrative examples.

Data Bases. Obtaining data for data bases may in fact be an activity that is indistinguishable from research. It will be noted in the examples at the end of this letter that the two tend to go hand in hand. Data bases are maintained principally to establish a standard against which new samples are compared. Without data bases, it would be impossible to make recommendations on such things as fertilizer levels, types of plants for differing growing season lengths, and the quality of nutrients in plant samples. Private, for-profit laboratories, incidentally, have access to university data banks. They, too, are dependent on the standards established by the colleges of agriculture.

Technology Transfer. The best example of technology transfer is soil testing. Most of the colleges of agriculture that conduct soil tests continually conduct research on the optimal levels of fertilizer necessary for various crops in various climatic conditions. In order to give farmers access to the latest research information, the university needs soil samples from the farmer's fields. Studies, which show that universities consistantly recommend less fertilizer than do the for-profit laboratories, demonstrate the importance of this process.

Examples

Plant Testing - University of Minnesota: The University undertakes varietal testing for a fee on three crops, alfalfa, soybean and sunflowers. Research scientists conduct tests in various sections for the state on many varieties of these crops. Crops are tested for yield, winter hardiness, disease resistance, agronomic traits and productivity rates in short growing seasons. Testing is done on public and private varieties to provide data to support recommendations to state farmers. Minnesota's far North location enables scientists to study the combined effects of long-day-lengths with short growing seasons. The university provides its unique data to other states, to companies, and to Minnesota Farmers. This particular research program supports an agricultural industry that results in over $1 billion in crop exports from Minnesota each year.

Water Testing - University of Wisconin-Madison: The University tests the mineral and nutrient content of both well water and surface water and retains a record of changes over time. Most water tests are conducted under contract with the state Department of Natural Resources and the state Department of Transportation. Continuous monitoring of state waters enables the university to warn state officials of changes that may affect both the utility of certain streams and ground water resources as well as pending pollution problems.

Plant and Pest Diagnostic Clinic - The Ohio State University: The Ohio State University Plant and Pest Diagnostic Clinic monitors the extent and frequency of plant diseases, insect pests, agronomic crop diseases, aquatic weeds and horticultural varieties. The program is not mandated by the state. The university data base includes a comprehensive overview of a broad plant population and it contributes data directly to research projects and to faculty in the university's Graduate School. The clinic gives both farmers and companies a source of unbiased information that is unavailable elsewhere.

Variety and Hybred Testing - Purdue University: Each year the university conducts tests of the commonly grown varieties of small grains, soybean, corn and several other crops. The results are used by farmers in making purchasing decisions. The data are also used to evaluate new varieties under development in the university's breeding program. Comparisons with the university's data base support decisions on the release of new varieties and inbred lines.

Bull Testing - University of Missouri-Columbia: The university conducts tests on approximately 6,500 bulls annually and charges a fee of $55 per bull plus the cost of feeding. The beef cattle data base is used to generate genetic parameters which are used by industry. From the data base, the university has generated adjustment co-efficients for scrotal circumference, height in the shoulder and hip, adjustments to a common age, and growth curves from weaning to 18 months. Four doctoral theses have been written using this data base.

Manure Analysis - University of Wisconsin-Madison: For its data base on manure types and nutrient content, the university maintains extensive records over time. Analyses enables the extension service to recommend levels of commercial fertilizers that will be necessary to augment natural supplies.

Soil Testing - Purdue University: The results of soil tests enables farmers to know optimal levels of fertilizer applications. Analysis data is retained in the laboratory and used to document long term trends in soil fertility in the state. Examples of the usefulness of this informartion are following:

> When the great Midwest farm depression of the late 1970's and 80's hit Midwestern farmers, most were hard pressed for operating money in the Spring of the year, planting time. The university was able to counsel them to reduce expenditures on phosphorous and potassium if need be. Purdue scientists knew from its soil data base that most soils in the state were strong in potassium and phosphorous and reduced applications for a year or so would not cause serious yield losses.
>
> In 1983-84, there were serious vegetable crop losses in areas with a high concentration of power plants. Many blamed the problem on air pollution. Data at the university, however, showed that the pH had been dropping in that particular section of Indiana and that lime was needed to nutralize the acid soil. Although some effects may have been cause by pollution, many of the plant symptoms were consistant with those caused by nutrient imbalances that result from acid soils. Lime treatments have improved yields and the crops are nearly back to normal.

We hope that these examples are helpful. They show that university data bases are critical to farmers whom the universities are dedicated to help. Loss of the data bases would mean a loss of standards against which both current crops and new crops are measured. In addition, research activities in U.S. colleges of agriculture would be seriously hampered if testing was ended or reduced because of a new tax liability

The members of the Midwestern Universities Alliance are pleased to offer this information. We hope it is helpful to the Subcommittee. We will be glad to provide an expert witness for the pending hearings if one would aid the Subcommittee in its continuing deliberations.

Sincerely,

Newton O Cattell

Newton O. Cattell
Director

COMMENTS TO THE HOUSE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE ON THE MATTER OF UNRELATED BUSINESS INCOME TAX

The following comments are submitted on behalf of The Minneapolis Institute of Arts, 2400 Third Avenue South, Minneapolis, MN 55404, an encyclopedic art museum founded in 1915 and with a collection of over 75,000 works of art.

On the matter of the "Substantially Related" test we would urge that the standard for an educational institution such as museums should encompass sales of objects relating to all the activities of the museum. This would cover sales of objects and books which add to the education and enjoyment of all programs such as concerts, films, and classes as well as exhibitions and collections. We are concerned that a "directly related" test might, in its extreme interpretation, exclude a museum from selling books about artists or art not in the collection even though related by art education or art history.

On the matter of "off-premise" sales by mail order we are concerned about the need to supply educational materials to schools and interested individuals at a distance, who are unable to travel to a museum easily. Sales of products related to exempt function should be excluded from UBIT.

Most museums struggle each year to make ends meet as it is and are not a threat to the small business community in dealing with sales of materials related to their purpose of educating the public in their discipline(s). It seems that some of the options would tend to inhibit nonprofit educational institutions like museums from distributing for sale reproductions and publications of their collections except on site and that the financial assistance for producing such items through royalty agreements might be reduced.

Respectfully submitted,

Marvin Borman

Marvin Borman, Chairman
Board of Trustees
The Minneapolis Society of Fine Arts
(parent organization of The Minneapolis Institute of Arts)

MINNESOTA MUSEUM OF ART

Jemne Building
Saint Peter at Kellogg
Saint Paul, Minnesota
55102

Landmark Center
Fifth at Market
Saint Paul, Minnesota
55102

612-292-4355
at both locations

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14 April 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth Building
Washington, DC 20515

Dear Counselor Leonard:

We are responding to Chairman Pickle's request for public comments on discussion options relating to the unrelated business income tax.

Minnesota Museum of Art is a small midwestern art museum annually serving about 130,000 people of a 2 million metropolitan area population. We do this with an operating budget of about $1.1 million annually. This is the first year in four (and only the second year in nine) that the Museum will not experience an operating deficit. We will achieve this modest surplus due to new contributions and significant increases in earned income.

Of our total income, 69.4% is contributed through donations, gifts and grants; 6.3% is provided by endowment funds; and, 24.3% is earned through programs related to our tax-exempt purposes of collecting, preserving, exhibiting and interpreting works of art.

Increasing our earned income has been an objective of the Museum's strategic plan since 1984. This strategy has been encouraged by nearly all parties who are interested in our Museum: state and local government, the business community, the philanthropic community, the media, and, indeed our own members and trustees. Even the federal government's posture toward non-profit cultural organizations has emphasized the notion of "self-help" and "earning" more of our operating income.

What concerns us about the current subcommittee discussions is that we will be taxed rather than rewarded for these efforts. Unlike the Dayton Hudson Foundation (a true inspiration for enlightened corporate giving) which rewards cultural organizations if their earned income reaches 35%; these items under discussion appear to penalize a museum like ours for even attempting to achieve such a goal.

We are able to carry out our mission of stewardship and education, in part, because we enjoy a consideration from the public-sector; it considers the work we do and the programs we deliver to be a service to our community. If this consideration is diminished, will it be eliminated? If it is narrowed at the federal level, what will happen at the state and local level?

Whatever the case, to maintain the scope and quality of this Museum's programs and services, any dollars lost through taxation will have to be recovered through contributions. Even in the most generous nation in the world, many of our cultural institutions have seen how unrealistic that task is as contributions flow more readily and necessarily to address ever more urgent social, health, and emergency needs.

We urge you and your committee to exercise great care and caution in this area. Earned income is an increasingly important component in a museum's operating budget. Most museums are financially delicate; overreaction to the miniscule abuse that some contend exists will deliver a demoralizing and potentially devastating blow to some of our country's best institutions.

Thank you for the opportunity to comment and your thoughtful consideration.

Yours very truly,

M.J. Czarniecki III
Director

cc: Bruce Vento, M.C.
Douglas M. Carnival, Chairman, Minnesota Museum of Art Board of Trustees

MJC/rrrk

The MIT Museum 265 Massachusetts Avenue, Cambridge, Massachusetts 02139, Telephone 617-253-4444

April 10, 1988

To: The Subcommittee on Oversight Committee
on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

From: Warren Seamans
Director
MIT Museum
265 Massachusetts Avenue
Cambridge, MA 02139
(617) 253-4444

Statement Re: Unrelated Business Income Tax

Arts funding has become increasingly competitive with the larger museums cornering the market on grants and endowments. Small museums have few funding outlets and the proposed tax legislation threatens to severely limit yet another vital source of funds: profits from the museum shop. Such legislation would not seriously effect the few major institutions such as the Smithsonian or The Metropolitan who are already well endowed and whose shops make substantial profits. Only a handful of the 6000 museums in this country fit that category, however, and the other 5995 must fight to afford every exhibit and every program they offer to the community.

To compare a museum shop to a commercial retail store is to compare a museum to a mall. One functions for the purpose of providing public enrichment, one functions for the purpose of accruing personal riches. Museum shop profits do not make richer an individual entrepreneur. Museum shops simply give crutches to many a crippled non-profit organization whose only function is to serve the community. Unlike a commercial retail operation, a museum shop must contribute to the financing of exhibits, publications, and educational programs of the museum it serves.

A division of the MIT Libraries

But a museum shop not only finances, it educates. The MIT Museum Shop, for example, offers educational books and games for all ages and capabilities. Most of our merchandise cannot be obtained elsewhere--although a few items may be found at other science museum shops around the country. We are one of the few stores in existence to offer products in the fields of science, mathematics, technology, and architecture. Commercial retail outlets don't sell this merchandise because, frankly, a Mathematics Calendar has a far narrower buying public than a Garfield Calendar. But to offset the limited popularity of our more nuts and bolts science merchandise it is necessary for us to boost sales with merchandise that might be considered "substantially related" such as Math-in-3D t-shirts and coffee mugs bearing the MIT insignia. Under the new tax legislation, however, profits will be cut from such merchandise that has become the life's blood of many a museum shop enabling it to offer less profitable but more educational products.

With regard to off-site sales, Museum Shops, housed as they are in museums and not malls, need to reach the public in any way they can. Unlike a commercial retail store, a museum usually has no say in its location, and if that location is far from prime, off-site sales are the only recourse. Surrounded as we are by burned out buildings and factories, the location of The MIT Museum is a definite detriment. If we had to count on in-store sales, our Museum Shop could not survive.

Satellite shops of museums such as ours function to overcome the problem of location. The MIT Museum depends on a traveling museum shop on campus to spread the word about our museum and to bring in profits for the museum shop which are, in effect, funds for the museum. If you are to discourage the use of satellite shops with new tax legislation, you are issuing a death warrant for many a museum plagued with a bad location. We are not talking about the Smithsonian here, or Monticello--but museums with small collections in out-of-the-way places. Such a museum has the deck stacked against it to begin with. The proposed tax legislation against satellite shops would be the last nail in the coffin.

Likewise, a mail order catalogue helps a museum reach out past the physical barriers of location. Our mail order catalogue serves to publicize the museum, and to draw an audience to The MIT Museum that could not be reached in any other way. It also allows us to raise funds from virtually all over the globe. Ninety-eight per cent of these people would not respond to a straight request for donation, nor would they have occasion to visit The MIT Museum. The MIT Museum Shop catalogue offers items of educational value to people who will never be able to visit Cambridge, Massachusetts. At the same time, it strengthens the reputation of our museum and brings in impressive numbers of heretofore uninitiated visitors. Still, the cost of producing a mail order catalogue is prohibitive, and we must again rely on popular merchandise which might be termed "substantially related" to carry expenses so that we may offer a strong selection of educational products.

Offering meaningful exhibits and programs to the public is a costly endeavor. A museum shop with modest profits cannot afford to support its own operation, the programs and exhibits of the museum it serves, and the federal government too. Representing the small museums across this country, I ask not for help, but simply for the opportunity to help ourselves. Every facet of the proposed tax legislation would effectively disable us in that regard.

STATEMENT OF MOODY BIBLE INSTITUTE OF CHICAGO ON CERTAIN UNRELATED BUSINESS ACTIVITIES OF EXEMPT ORGANIZATIONS

April 15, 1988

Moody Bible Institute
of Chicago
820 North LaSalle Street
Chicago, Illinois 60610

312/329-4000

Of Counsel:
William J. Lehrfeld, Esq.
1101 Connecticut Avenue, N.W.
Washington, D.C. 20036

202/659-4772

I.

INTRODUCTION TO MOODY BIBLE INSTITUTE OF CHICAGO

The primary mission of Moody Bible Institute of Chicago is to provide an institute of higher education in religious studies for the education and training of Christian workers. MBI was founded in 1886 by evangelist D.L. Moody and its work includes its educational programs, its publishing of religious periodicals, its television and radio broadcasting of missionary messages and sponsorship of a multitude of other church and religious activities. It is classified as a school and not a church.

In 1986, it expended almost $47 million in support of its programs. Sums were raised from the general public through contributions, from program service revenues, from endowment earnings and from certain unrelated business activities (magazine advertising).

It also operates religious book stores both on and off its Chicago campus which sell religious literature and religious related goods to its students and the general public. Its 1986 program service revenue included $6.2 million of student fees, $1.7 million in public service revenues, $16.8 million in the sale of its periodicals and other religious literature, and $850,000 in miscellaneous income. It grossed $1.7 million in commercial advertising income, and paid federal income tax on its net net advertising gains.

Instruction is offered in day and evening divisions and by correspondence. Enrollment in the day school for the Spring semester of 1986 was 1,294 students and for the Fall semester enrollment was 1,398 students. During 1986, there were 2,179 students enrolled in the evening school. Receipts from this educational program include student fees, principally for room and board, evening school tuition, grammar and high school tuition, and incidental receipts from activities relating to the educational departments. With respect to its media role, programs are produced by the Institute's own noncommercial educational radio stations. Some of these programs are also distributed to other radio stations not owned by the Institute. Gross receipts attributable to this program consists only of reimbursements from other stations for the cost of duplicating and mailing program tapes produced by the Institute.

With respect to its publishing and distributing of evangelical literature, textbooks, reference works, tracts and other literature, such items are written, published and sold through various channels. A monthly magazine ("Moody Monthly") is published and distributed to 187,000 subscribers. Periodical receipts from subscriptions from the general public approximated $2.2 million.

II.

SUMMARY OF MOODY BIBLE INSTITUTE OF CHICAGO CONCERN

Moody Bible Institute grossed approximately $1.7 million from the sale of commercial advertising which is published in "Moody Monthly." Because subscription income exceeded its editorial or readership costs, the net advertising gain in 1986 was not reduced by excess editorial costs. 1986 was the first and only year in which subscription income exceeded editorial or readership costs. In 1985, 1984 and 1983, readership losses in excess of subscription income reduced the net advertising gain to zero. Our method of allocation for subscription income to readership costs, to determine a net gain or loss on this exempt function, was expressly approved by the Internal Revenue Service and has been ratified by later audits.

Moody Bible Institute is very concerned with the proposed repeal of the deduction allowed with respect to readership costs to the extent they exceed readership income. We believe that elimination of the deduction would create a major hardship for religious and charitable publications and unnecessarily punish these entities when serving the religious or charitable interests of the public. The Subcommittee on Oversight propounded the idea that the costs (ordinary and capital, as amortized) of publishing a periodical attributable to readership or editorial content should not be deductible in computing net advertising gains. The option was stated as follows:

> "Allow an exempt organization to deduct from advertising income only those direct advertising costs and not circulation expenses. Thus, only costs directly connected with the sale and publication of advertising could offset advertising revenues. The excess of readership costs over circulation income would not be deductible for the purpose of determining UBIT from advertising income.

> "Example:
>
> "An exempt organization publishes a magazine in furtherance of its exempt purpose. The annual costs directly connected with the production and distribution of the readership content of the magazine are $150. Annual circulation income from the magazine equals $100. Advertisers annually pay $50 to place ads in the magazine. The exempt organization incurs $10 of expenses directly connected with the sale and publication of advertising.
>
> "Under current regulations the organization owes no UBIT with respect to advertising income. Under the proposal, the organization would have $40 of UBIT which could not be offset by any part of the $50 excess of readership costs over circulation income."

This option was later re-stated in Subcommittee Press Release No. 16, March 31, 1988, as follows: "J. Apply UBIT to advertising income and allow deductions from UBIT only for direct advertising costs."

The effect of this alteration could cause a serious economic problem for many religious publishers such as Moody Bible Institute, and such other public charitable organizations with periodicals which incur excess readership costs in support of their exempt function. We believe it is both unnecessary and inequitable to create a per se rule for certain expenses that are obviously directly connected to the production of the advertising income. On the other hand, it is not objectionable from our standpoint to create a per se rule for commercial advertising income which diseregards the educational content of a commercial ad, or the value of the ad to the readership, or the purpose served by taking and publishing the ad by the exempt organization in its periodical. See, Subcommittee Option J at p. 8. The Government has long argued for a per se rule in this area, but the Supreme Court chose to give a different reading to Government regulations, the legislative history involving the taxation of advertising income, and other aspects of the administration of the tax which conclude that there is now, no such per se rule for commercial advertising. See, American College of Physicians v. United States, ____ U.S. ____, 106 S.Ct. 1591 at 1598-1599 (1986). Legislation on this point is not objectionable.

III.
LAW AND ARGUMENT

The proper tax treatment for the gross revenues from commercial advertising has been at rest at least since 1986 when the Supreme Court decided American College of Physicians, supra. Despite ACP arguments, it was fairly well understood by periodical publishers that commercial advertising income had been treated with finanity not only by the Congress, in its 1969 review, but by the Internal Revenue Service in its 1967 regulation. 1/ The 1967 regulation was the result of a project undertaken in 1960 to study the issue of whether or not an unrelated business could be conducted as an integral part of a related business. The need to do so was pressed by commercial publishers which were claiming, rightly so, that nonprofit periodicals were unfairly competing with them by paying no taxes on similar ads. 2/ The Internal Revenue Service had generally been of the view that with a periodical, only one trade or business existed, a unified one consisting of both the editorial content (sometimes income producing) and commercial advertising (always income producing). The matter had been addressed in the context of a periodical since discontinuous or irregular publications, containing commercial advertising, would not be taxed because of the "regularly carried on" prerequisite in existing law. The 1967 regulation recognized that the periodical contained more than one trade or business and generally altered the rule, at least as to trade association's, that advertising income would not adversely affect an association's tax exempt status under Section 501(c)(6). 3/ Advertising income has generally never been regard~~d~~d as an instance of inurement for a Section 501(c)(3) organization such as Moody Bible Institute because our organization, and other religious and charitable institutions publishing periodicals, generally serve the public and not the interests of a professional membership or various line~~s of~~ business.

The Treasury regulations which, then and now, have effectively governed the taxation of a periodical's net income, recognize that, with respect to expenses, the periodical is a unitary business. 4/ Therefore, all of the editorial expenses or readership costs should be allowed as a deduction for they are incurred in connection with the production of both advertising income and readership income. Desirability of deducting these profit motivated expenses is to assure that only net income from

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1/ T.D. 6939, C.B. 1968-1, 274.

2/ Amicus brief of American Business Press, in American College of Physicians v. United States, S.Ct. No. 84-1737 at 9-15; see also, "Tax Reform, 1969" Hearings Before Committee on Ways and Means, House of Representatives, 91st Cong., 1st Sess., Vol. 3 at 1144-1154 (same argument, same proponent) (hereafter, "1969 House TRA Hearings").

3/ Substantial, untaxed advertising income earned by a trade association was grounds for revocation of exemption under the inurement theory, prior to the Revenue Act of 1950. American Automobile Assn, 19 T.C. 1146 (1953). National Leather and Shoe Finders Association, 9 T.C. 121 (1947).

4/ Regs. § 1.512(a)-1(d)(2), T.D. 6939, supra. Regs. § 1.512(a)-1(f)(6), 1988.

the enterprise is subject to tax. No expenses are deductible, under existing law, if the expenses are not "directly connected" to the production of income which is taxable or exempt. However, prior to allowing the editorial or readership expenses to be deducted, these expenses must first be reduced by the amount of income attributable to paid subscriptions or allocations of membership dues are made. 5/

The original advertising and overhead regulations were supported by two major for profit advocates during the 1969 hearings. For example, in the oral testimony of Mortimer Caplan, the spokesman for the National Tax Equality Association, it was stated:

> "After careful study of the relevant portions of those regulations, however, I am convinced that the taxation of advertising income represents an entirely valid interpretation of existing law. The position of the regulations on this point is strongly supported by the definition of 'business' in the legislative history of the 1950 statute; it is direct accord with the fundamental policy of the unrelated business income tax; and the rules provided by the regulations for the allowance of deductions -- insuring that no tax will be due unless the publication earns a net profit, and that the tax will be only upon that net profit -- are fair, balanced, and reasonable." 6/ House Hearings at 970-971.

Likewise, in connection with the oral statement of the American Business Press, although the American Business Press supported the regulations (1969 House TRA Hearings at 1182-1183) it did not expressly address the net effect of the editorial cost association with net advertising gains. Its continuing theme, however, was:

> "When Congress passed the unrelated business income tax, it passed general legislation covering publishing and advertising. It was concerned with unfair competition on the part of tax exempt organizations. And Congress took into account the fact that under one set

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5/ Regs. § 1.512(a)-1(f)(3) and (4).

6/ 1969 House TRA Hearings at 970-971.

> of circumstances, a business activity would not be taxable, and that in another set of circumstances, the same activity would be taxable. Congress granted discretion to the Internal Revenue Service to determine where the unrelated business income tax should apply."

The essence of the 1967 regulation, and existing regulations, recognizes that the editorial content of the magazine, and its expenses, enhance the value of the advertising to the reader of the periodical. Of equal importance is that editorial costs first had to be offset by an allocation of subscription income (or dues, etc.) to assure that editorial income did not lose its character as such due to the need for the periodical to pay its own way in some fashion. Regs. § 1.512(a)-1(f)(4), allocation of membership receipts. Establishment or "creation" of income to fairly reduce editorial costs is governed by the aforecited regulations, which are under court challenge. But a periodical cannot fairly be evaluated without this profit motive, a prerequisite of Section 513(c) and its allowance of losses in profit motivated enterprises. Congress wanted to make absolutely certain that a periodical which was not profit motivated (to earn exempt income to offset editorial losses before allocation to net advertising gains) or gross income from advertising (which nonetheless produced an advertising loss), could not produce losses to offset any unrelated business gains. The regulations fairly established and recognized, as a matter of principle, that you could not create artificial losses using other publications which did not carry any advertising and use those editorial losses to reduce or eliminate the net advertising gain from the periodical which did. Thus, for example, Chairman Mills, during floor debates on the advertising tax stated as follows:

> "In discussing the effect of defining the term 'trade or business' and the effect of consolidation when more than one publication is involved, the Committee report indicated that all publications, as to both income and expenses, would be treated on a consolidated basis. And in addition, it was stated that regulations' authority was provided to 'prevent avoidance of the unrelated business income tax.' Concern was expressed that in defining a trade or business, the statute suggested that even if the trade or business did not make a profit, the losses would still be treated as arising out of a trade or business and therefore permitted to offset profits from other trades or businesses. Concern was expressed that the language of Section 513(c) would eviscerate the advertising tax because organizations which publish periodicals containing no advertising

> would be permitted to use those "losses" to offset net net advertising gains from taxable publications."

Mr. Mills countered that idea with the following statement:

> "It is the last phrase of the sentence that the gentleman read from the report which makes it certain that there is no negation whatsoever of the language which is in the bill. The language in the bill refers to 'any activity which is carried on for the production of income.' To me the language carried for the production of income has a very definite meaning. It does not mean publishing a magazine with no advertising and distributing that magazine for free. That type of magazine is published as a source of public information, not for the production of income. For a publication to be considered an activity to be carried on for the production of income, it must be contemplated that the revenues from advertising in the publication or the revenues from the sale of the publication, or both, will result in income.
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> * * *
>
> "Mr. Mills. I could not possibly so interpret [the language in Section 513(c)]. I doubt that anyone can consider a publication which is distributed for free and which formerly carried no advertising as being turned into a publication carried on for the production of income merely because one advertisement was placed for publication.
>
> * * *
>
> "Mr. Mills. The organization would not be permitted to consolidate the losses of a publication not carried on for profit with the income from other publications which are carried on for the production of income, so as to reduce the unrelated business income arising from these publications. Consolidation would be permitted only where each publication to be consolidated was carried on for the production of income." Cong. Rec., August 7, 1969, at H7076-7077 (daily ed.)

Thus, it was obvious that the profit motive required by Section 513(c) encompassed only those periodicals which produced income, related and unrelated. Those periodicals were given the opportunity to offset net advertising gains with net editorial costs (after reduction for subscription income) in order to assure a fair and reasonable tax base. The United States of America, in its brief to the Supreme Court in American College of Physicians wrote that theme this way:

> "Non tax exempt publishers of trade and professional journals, on the other hand defended the regulations as a check upon the perceived inequity and any competitive effect affording a tax subsidy to their tax exempt counterparts.
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> * * *
>
> "They maintained that their periodicals, no less than those of their tax exempt competitors, helped keep readers professionally up to date. They emphasized that all publishers whatever their tax status, vie for advertising dollars using the same sales techniques. They noted that tax paying and tax exempt publishers regularly run identical ads -- indeed, a pair of competing chemical publications had once run 115 identical ads within a space of six months.
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> * * *
>
> "Congress resolved the controversy by endorsing the regulation and paving the way for its enforcement.
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> * * *
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> "The legislative history accompanying Section 513(c) plainly shows that Congress intended to codify the treatment of advertising income prescribed by the 1967 regulation." Brief of the United States, American College of Physicians v. United States, U.S.S.Ct. 84-1737 at pp. 20-22.

The entire effect of the 1969 legislation was to level the playing field so that tax exempt publishers and taxable publishers competed on the same terms. Those same terms, as constructed, permitted editorial or readership costs to be deductible by tax exempt publishers just as they are deductible by taxable publishers. There was no apparent Congressional desire in 1969 to limit the taxability of net net advertising gain to net advertising gain, viz, by not permitting net editorial expenses to be utilized for the computation of net taxable income. This would, indeed, have imbalanced the situation and create a liability on a phantom profit. Today, in effect, the Association of Business Publishers, which endorsed the regulations in 1967 and which supported the enactment of Section 513(c) in 1969, now wishes to reverse its direction and tax the net editorial income of tax exempt publishers. 7/ In essence, it argues that there is no distinction in purpose or intent between National Geographic, or other educational magazines, and any magazine owned by an entrepreneur. It argues that the term "educational" should be removed from Section 501(c)(3) and that organizations which have no owner in an entrepreneurial sense, and whose assets are dedicated, as a matter of law, to charitable purposes in perpetuity, should bear the same tax burden as a magazine the owner of which can buy and sell the property like any other property. This argument, seems to accept the idea that education is only education when it is conducted for free.

Federal courts have only sanctioned that argument where it is clear that the persons controlling the educational entity are using it for their private entrepreneurial purposes rather than for the benefit of the public. 8/ The staff options, in effect, adopt some of this argument not by taxing net editorial income, which is often nonexistent, but by disallowing net readership costs. By so doing, it is seeking to reverse the competitive balance that Congress achieved in 1969. It also assumes that editorial costs would never be reconstructed by sympathetic courts to be deemed direct advertising expenses. If the proposal were adopted, it would of course require Section 501(c) publishers to make greater use of their exemption by pricing their periodical through subscriptions or dues so that they could create a tax exempt profit from the periodical. This probable effect certainly would be an illogical result in an attempt to create a fairer and more balanced mode of taxation for commercial advertising income.

We believe that the goal of the unrelated business income tax would be disserved by not permitting the deduction of all expenses "directly related" to the production of gross income from advertising. To prevent abuse of the editorial cost allocation, we have the following suggestions:

1. Section 501(c)(3) organizations operate for the benefit of the public at large and not for any particular constituency. The profits it derives from its exempt function and the net income, after tax, from its unrelated business activities, cannot

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7/ 1987 UBIT Hearings at 1357-1358. Cf., Scripture Press Foundation v. United States, 285 F.2d 800 (Ct.Cl. 1958).

8/ Contrast, Incorporated Trustees of Gospel Workers Society v. United States, 510 F. Supp. 374 (D.D.C. 1981), aff'd 672 F.2d 894 (D.C. Cir. 1982) with Presbyterian & Reformed Publishing Co. v. Comm'r, 743 F.2d 148 (3d Cir. 1984).

be used to create empires of personal wealth which can be distributed in lump sums, or in dissolution to private parties, which is the case with membership entities like associations and unions. Therefore, if statutory changes are to be made, the Subcommittee should create one rule for periodicals of charitable and religious entities and more stringent (and protective) rules for noncharitable membership entities.

2. The 1969 legislation, affirming the decision of the Internal Revenue Service to tax net income from advertising, was premised on the idea of making competitors for the same consumer dollar equal in their treatment as to items of gross income and equal in their treatment as to items of expenses. To disallow the expense attributable to the editorial or research costs per old Regs. § 1.512(a)-1(b)(2) and existing Regs. § 1.512(a)-1(f)(6) would be to unbalance an otherwise workable situation when dealing with Section 501(c)(3) organizations and their periodical income. Certainly, there is an argument that if a trade association, operating primarily for the benefit of its business members, can absorb this educational expense from outside parties, through gains from commercial advertising, then there may be an element of unfairness as to how a membership organization should support its members without cost to these same members. That is to say, it is a longstanding rule of law that trade associations must be supported by the membership if the organization is to enjoy the exemption from tax. See fn. 3, supra. If, on the other hand, the burden of support for the trade association comes from outside the membership, then the exemption from tax is not working the way it should to support that sort of mutual benefit organization.

We believe there is a reasonable argument for differentiating between editorial costs which absorb net advertising gain by trade associations and editorial costs which absorb net advertising gains by Section 501(c)(3) organizations. In one instance, the members of a mutual benefit organization are gaining business value from third party sources and the profitability of their lines of business are enhanced at a cost to the Treasury. On the other hand, a Section 501(c)(3) periodical whose net advertising gains are reduced by net editorial costs is only benefiting the public and not any special business segment thereof.

3. It is not unreasonable to expect that there be a "profit motive" from the distribution of a periodical where the periodical can rightfully find a market for its editorial content. It is clear that in the context of a trade association, that some profit motive should be required so that no artificial pricing can exaggerate the editorial costs and thereby reduce the tax liability improperly or unfairly. We therefore suggest that the dues allocation rules now in Regs. § 1.512(a)-1(f)(3) be enacted to require a "profit motive" in pricing the editorial content. Many religious publications and many publications of charitable organizations, cannot be priced to sell because the editorial content is not sufficiently broad or entertaining to warrant members of the general public to purchase it. While there are many many instances, including "Moody Monthly" where a subscription price can return in value the costs associated with readership content, a legislated "pricing" requirement should not be borne by Section 501(c)(3) periodicals.

GUILD HALL

April 8, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

As an art museum chartered under the 501 (c) (3) tax code provisions, we are ever mindful of our role as an educational institution. Our income-producing ventures, such as the museum shop, publications, reproductions, tours and other such activities are geared toward audience development and community enrichment, and therefore serve the purposes broadly outlined in our charter. In addition, they provide a significant percentage of museum revenues, supplementing income from federal, state and county grants. The more we can generate such funding, the less we need to rely on public monies to cover operating and programming costs. The tax-exempt status of income generated by shop sales (on- or off-premises) and other constituency services can account for a significant proportion of cultural institutions' revenues. The degree to which they have capitalized on the potential of such ventures in recent years demonstrates a willingness to develop alternative funding strategies, an attitude that the federal government should encourage, not penalize. We strongly believe that as long as the income-producing activity can be shown to be "substantially related" to the institution's tax-exempt purposes it should not be subject to the Unrelated Business Income Tax.

We consider our concern to be, in the words of Chairman Pickle's memorandum, both "strong and appropriate," and we urge you to act in the best interests of the public we serve by continuing the current exemptions for museums chartered under Section 501 (c) (3).

Sincerely,

Judith B. Sneddon

Judith B. Sneddon
Executive Director

THE MUSEUM SECTION
MORAN AND WOODHOUSE GALLERIES
THE JOHN DREW THEATER
East Hampton
N.Y. 11937
158 Main Street/TEL. 516-324-0806/324-4050

April 11, 1988

STATEMENT IN RESPONSE TO PRESS RELEASE #16, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES. BY CHARLES E. HANSON, JR., VICE-PRESIDENT, THE MUSEUM ASSOCIATION OF THE AMERICAN FRONTIER; HC 74, BOX 18; CHADRON, NEBRASKA 69337; A 501 (C)(3) ORGANIZATION.

Our organization operates an historical museum and historic site, does extensive research in specific areas of North American history and publishes books based upon our research which are illustrated to an important degree with objects from our museum collections. Seventy-four percent of our museum visitors come from outside our home state and eighty-four percent of our members live outside the state. For this reason the major percentage of our publication sales is by mail.

We feel sure that these publications do much to further our exempt purposes and their sale provides much needed funds for our museum and research activities.

There are many organizations like ours which serve their members and patrons on a state-wide or nation-wide basis. We believe that all of them would be penalized if the exception to Unrelated Business Income Tax were limited to on-premise sales. This particularly applies to those museums which are not located in metropolitan areas where most of the members and patrons can visit the "book store" in person.

Charles E. Hanson, Jr.

MUSEUM OF NEW MEXICO FOUNDATION

April 14, 1988

The Hon. J. J. Pickle, Chairman
Subcommittee on Oversight, Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Building
Washington, D. C. 20515

Dear Representative Pickle:

I am writing on behalf of the Board of Trustees of the Museum of New Mexico Foundation to urge the Subcommittee on Oversight to submit to most serious scrutiny the impact of imposing unrelated business income tax on non-profit revenue-producing activities.

In general, this step would further vitiate the ability of the non-profit sector to support cultural, educational, and social services throughout the nation--ironically, at a time when the prevailing atmosphere in Washington is to turn such responsibilities back to the private sector.

Specifically in our case, our museum shops, operated by the Foundation to benefit the Museum of New Mexico, yield approximately half of the total annual support we contribute to the Museum in the form of program grants. These funds are therefore crucial to the maintenance and development of the Museum of New Mexico as a major cultural and educational institution in a state where contributions to the arts and culture are hard come by. To the degree that our revenues are reduced by UBIT, the Museum will be less able to perform its services to the people of New Mexico and to the some 1,000,000 visitors who come to the Museums each year.

We have no indication that any losses through the imposition of UBIT would be offset by small business support of the non-profit institutions.

Sincerely,

Sandra Edel

Sandra A. Edelman
Executive Director

P.O. Box 2087, Santa Fe, New Mexico 87504-2087 (505) 982-6366

The
MUSEUMS

1208 Route 25A, Stony Brook, NY 11790 (516) 751-0066

April 11, 1988

The Honorable J. J. Pickle, Chair
Subcommittee on Oversight, Committee on Ways & Means
U. S. House of Representatives
Washington, DC 20515

RE: Discussion Options: Unrelated Business Income Tax

On behalf of the trustees and staff of The Museums at Stony Brook, Long Island, and of the public they serve, I, Susan Stitt, Director, am writing to express our grave concern regarding some of the proposed options for changing the substantially related standard for the Unrelated Business Income Tax.

I.A. Gift Shops and Bookstores

(on premises)
The interpretation of what constitutes "educational nature" is key as it is proposed that items of an educational nature would be exempt from UBIT. We do not understand why a guide to a museum's paintings would be exempt from UBIT but a general art history book, which provides the historic context for the museum's paintings, would not be exempt. Both items are educational; both are related to the museum's exempt purpose.

In The Museums case the catalog we published of The Museums decoy collection would be exempt from UBIT but books by other publishers on decoys would not be exempt. We ask the committee to consider that in this instance no bookstores within 25 miles carry publications on decoys. The Museums is not competing with other bookstores, but, by seeking out these books and making them available, is providing an educational service to the public whose interest in decoys has been stimulated by seeing our exhibit.

(off premises)
Would museum publications be exempt from UBIT as mail order sales under the proposed revisions? This is of cardinal importance to The Museums, for our publications on our decoy, carriage and art collections are the only way that many people can gain access to these important materials since many people cannot afford to visit Stony Brook. We consider our mail order sales to be directly related to our exempt purpose in preserving these materials and making them available to the public. In this instance, too, when we are asked to furnish a vendor book in one of our specialized subject areas, we believe we are providing an educational service.

Sincerely,

Susan Stitt

Susan Stitt
Director

SS:ps
c: Hon. George Hochbrueckner
Hon. Thomas Downey
Hon. Robert Mrazek

MUSKEGON
MUSEUM OF ART
HACKLEY GALLERY WALKER GALLERY
1912 ◆ 1987 75 YEARS—REDISCOVER THE TREASURE

RECEIVED
PR 11 1988
ys and Means
Subcommittee on Oversight

April 8, 1988

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight, Committee on Ways and Means
U. S. House of Representatives
1105 Longworth, House Office Building
Washington, D. C. 20515

Dear Congressman Pickle

SUBJECT: "UBIT"

As a non-profit (501)(c)(3) art museum director, I view with great alarm and concern several of the options your committee is pursuing on the issue of taxation of non-profits' revenue producing activities. The non-profit museum field is under tremendous pressure to survive and continue to protect a vital national treasure: our cultural heritage. Passage of these restrictions would place yet another obstacle in our path of producing sufficient revenue to just hold on.

Specific changes in options, that you are considering, which I feel you should reject are:

- I. Substantially Related Standard
    - A. Gift Shops and Bookstores
    - D. Travel and Tour Services
- II. Convenience Exception
- IV. Royalty Exclusion

In our operation, at the Muskegon Museum of Art, these options are provided for area residents as a service which cannot be found anywhere else in a 150-mile radius. Our patrons know its importance to our operation, as well as receiving skilled, tasteful and academic experiences that they cannot get anywhere else in our immediate area.

I emphasize, we are not in competition with for-profit organizations.

Also, I offer the plea that someone should realize that museums are constantly under pressure to receive less funding from government and corporations in the Michigan area because of the poor business climate. Now museums might be expected to be taxed and then lose potential revenue supporting activities because the margin of profit in these activites is so slim.

Please consider our goal, that we are the protectors of the visual heritage of our nation. We could be taxed and regulated, if not out of existance, at least into a non-productive position.

Please reject changing the options as they now exist.

Sincerely,

Al Kochka
(bjo)

Al Kochka
Director

AK/bjo

COMMENTS OF THE NATIONAL ASSEMBLY OF NATIONAL VOLUNTARY HEALTH AND SOCIAL WELFARE ORGANIZATIONS AND THE GRANTS AND CONTRACTS PROJECT ON DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

Ways and Means Committee
U.S. House of Representatives
April 15, 1988

The National Assembly of National Voluntary Health and Social Welfare Organizations and the Grants and Contracts Project appreciate the subcommittee's courtesy in extending the opportunity to comment on various options for changes in the unrelated business income tax. The National Assembly is an association of national voluntary human service organizations whose members collectively serve over 50 million people each year. The Grants and Contracts Project, which exists to improve governmental administration of grants and contracts with nonprofit health and human service agencies, is made up of fifteen national voluntary human service organizations. A membership list for both organizations is attached.

We appreciate the subcommittee's openness in inviting comment on these discussion options prior to the formulation of specific legislative proposals. Several of the subcommittee's options, particularly those that couple better reporting concerning income-producing activities with a reduction of the filing and paperwork burdens on the smallest nonprofits, hold the promise of generating useful information on which Congress and the Treasury can make policy judgments concerning nonprofits' income.

However, the general nature of the descriptions of the options frequently makes it difficult to predict their full impact on the traditional activities of nonprofit human service organizations. This is particularly true for the various changes suggested for the "substantially related" standard and for the option to repeal the regularly carried on test. Because of the importance of the various proposed options to the nonprofit community, we urge the subcommittee to seek additional comment when more specific proposals have been formulated.

For convenience, our comments follow the order given in the subcommittee's press release. Five options stand out, however, for the magnitude of their potential impact on the operations of human service organizations. Three of these concern possible changes in the substantially related test, the fourth is the suggested repeal of the "regularly carried on" test for measuring whether an activity is a trade or business and the fifth is the proposal to tax most forms of royalty income.

We urge the members of the subcommittee to preserve the "substantially related" test, to preserve the fragmentation rule for measuring the relatedness of individual activities, to avoid classifying activities as taxable on the ground that they are "inherently commercial," to avoid imposing substantial new constraints on traditional fund-raising activities by repealing the "regularly carried on" test, and to avoid imposing the unrelated business tax on genuinely passive royalty income.

I. Substantially Related Test

The subcommittee's press release identifies two alternatives to the current "substantially related" standard for deciding when an organization's income should be subject to the tax on unrelated business income. They are: i) substitute a "directly related" test for substantially related; and ii) determine whether each income-producing activity, standing alone, is tax exempt.

Current Law

Current law already requires that to be "substantially related," an activity must bear a substantial causal relationship to the achievement of an exempt purpose. To have such a relationship, the sale of goods or performance of services must "contribute importantly to the accomplishment of the organization's exempt purpose". Without an explanation of what the "directly related" test means, we can only assume that the intent is to tighten the current test. But, how much tightening is intended?

Courts and the IRS have been interpreting the substantially related test for nearly forty years. For the most part, this test has done its job of distinguishing between activities that should be tax exempt, because they contribute importantly to the fulfillment of an exempt purpose, and those that should be taxed. Adoption of a different, but undefined, test would plunge IRS and nonprofits into a lengthy and costly period of rulemaking and litigation to define the parameters of the new test, while doing little to assuage the complaints of small business representatives. We strongly urge the subcommittee to preserve the current test.

Fragmentation Rule

Similarly, it is difficult to distinguish the suggested second test -- determining whether each income-producing activity, standing alone, is exempt -- from the current fragmentation rule. Section 513(c) of the Code already provides that an "activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization." Human service organizations welcome scrutiny of all of their activities; they believe their activities should be examined individually to determine if they are taxable. However, this scrutiny should take place, as it does under current rule, within the framework of the relatedness standard, not in artificial isolation from an organization's other activities.

For example, current regulations exempt sales of goods produced in the course of carrying on an exempt function. Thus, income from selling goods made by disabled persons in the course of a rehabilitative training program is not taxable so long as the program is no larger than necessary to carry on the training function. This exception recognizes the importance of a realistic setting for vocational and rehabilitative training. However, if the sales activity were judged in isolation from the training activity, as it might be under the proposed "standing alone" standard, the sales activity might become taxable.

We urge the subcommittee to retain the current fragmentation rule for judging the taxability of individual activities.

Applying Current Law to Specific Activities

The third basic option is to retain the substantially related test, but clarify its application to certain activities. We believe this approach is an appropriate one for the subcommittee to take with regard to some activities about which questions have been raised. However, we urge the members to avoid characterizing any activities as "inherently commercial" or using that term as a litmus for determining when activities should be taxed. Congressional guidance on whether certain activities contribute importantly to the accomplishment of an exempt purpose is appropriate, but injecting a wholly new concept, "inherently commercial," into the analysis will only lead to confusion about the legal test for determining when activities are subject to tax. Already some advocates of a commerciality standard are pointing to use of those words in the subcommittee's press release as signaling adoption of a new standard for nonprofit activities.

The idea that certain activities are "inherently commercial," without regard to why and how the activity is carried on, disregards the reality that many human service organizations, like other nonprofits, carry on a variety of activities, including some of the activities on the subcommittee list, which have commercial analogs. They do not, however, do so for commercial (i.e. profit-making) reasons and rarely realize a surplus from providing them.

The subcommittee's task, as it applies the relatedness standard to the activities specifically identified in the press release, will be to distinguish between activities that do contribute importantly to the fulfillment of an exempt purpose and those that do not. This is what the subcommittee apparently did in considering health and fitness centers where the option suggests taxing only those programs which are not available to a reasonable cross-section of the general public, such as by scholarships or by fees based on community affordability. In discussing the specfic areas identified by the subcommittee, we will suggest certain activities for which exemption should be similarly preserved because the programs are made available to a reasonable cross-section of the community. .

A. Gift Shop/Bookstore Income and Off-Premises Sales.

Income from these sources is a relatively small source of revenue for nonprofit human service organizations. However, if universities are to be allowed an exception for low-cost items, consideration should be given to exempting similar sales by other nonprofits which may stock a small number of items to promote use of a facility or service. Accordingly, we urge the subcommittee to exempt sales of low-cost items (subject to a dollar cap) for the convenience of members, students, patients, employees and officers of all nonprofit organizations.

We also believe that the suggested exception for hospital gift shop sales of items for use by inpatients should apply to nursing homes and other chronic care facilties. The same rationales that justify sales for the benefit of hospital patients apply to other health care facilities as well.

The off-premises sales provision should not apply to catalog or mail-order sales of books, research papers, professional journals, audio-visual materials and other

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documents produced by exempt organizations in the course of carrying out its exempt purpose. Many human service organizations produce a variety of educational materials for sale to other organizations and to the general public. Among other things, publication and sale of these materials plays an important role in disseminating social-science research, in describing innovative programs and techniques and in educating the public about human services issues. Most of these items have a relatively limited audience, making catalog and mail-order sales the only practical distribution mechanism. We urge the subcommittee to preserve the tax exempt status of income from sale of these materials.

A number of organizations sell, through catalogs, mail-order and by other "off-premises" means, other items used in relation to program services. Thus, as part of its services to its members, United Way of America circulates a catalog to its local affiliates of items, such as pins, placards and other mementos bearing the United Way logo, which affiliates may purchase for use and distribution in United Way fund-raising campaigns. Scout uniforms and accessories often are sold through local clothing outlets or by mail-order through Scout magazines and catalogs. Sales of this type, to an organization's members, affiliates and program participants, should not be taxed.

B. Sale or Rental of Medical Equipment, Devices, Laboratory Testing and Pharmaceutical Drugs and Goods. Some human service organizations sell or rent medical equipment and devices at less than cost, apply a sliding-scale fee to determine how much an individual should pay, stretch out payments without charging interest, and distribute some equipment free. Other organizations make specific laboratory tests and medications available free of charge, or at reduced rates, in order to encourage access to the tests, devices or pharmaceuticals. Organizations such as the Red Cross or an AIDS clinic may offer AIDS testing to the general public, some Jewish Community Centers offer Tay-Sachs testing to encourage identification of carriers of the Tay-Sachs gene, and organizations devoted to the prevention and treatment of specific diseases may cooperate in making orphan drugs available to persons afflicted with the disease.

There are strong public benefits from encouraging these organizations to continue these activities. Many individuals who fear they may have contracted AIDS, for example, may be more willing to seek out tests from an organization devoted to AIDS because they believe their privacy will be better protected. A Jewish Community Center, with its many contacts with young Jewish adults, has a unique opportunity to assist in identifying individuals who are carriers of the Tay-Sachs gene. Other organizations may make hearing aids available to persons who otherwise could not afford to pay for them.

Tax exemption signals society's support for these activities. Accordingly, the subcommittee should exempt sales and rentals of medical equipment, devices, laboratory testing and pharmaceuticals where the organization makes them available to a reasonable cross-section of the community based on the community affordability test outlined for health and fitness activities.

C. Income from Health, Fitness, Athletic and Recreational Activities. We believe that the test suggested is an appropriate one for determining the tax exemption of these activities.

D. Travel and Tour Services. This recommendation presents four issues. First, a number of organizations, such as YWCA's and YMCA's, regularly engage in cultural exchange and study programs which are arranged by the organization for officers and members of the organizations. We believe this type of exchange should continue to be recognized as fulfilling an exempt purpose.

Second, many youth organizations, such as Camp Fire, the Girl Scouts and the Boy Scouts, sponsor study trips, field trips and cultural exchange programs. These are not fancy trips with slick brochures and first-class hotels, but they are an important part of the activities of many youth organizations. The travel itself is educational and enriching for the youth involved. Moreover, the process of earning money to pay for the trip fulfills an important educational purpose by helping youngsters to work cooperatively toward a common goal. Ground arrangments typically are made directly by the organization; air, rail or bus tickets usually are purchased from a travel agent. The organization acts as agent, collecting payments from the would-be travelers and paying the money received over to the appropriate recipient. We believe these activities have a minimal impact, if any, on competition and urge the subcommittee to preserve the exemption for travel and tours substantially related to fulfilling the exempt purposes of youth organizations.

Third, many human service organizations arrange trips for the elderly, for persons with disabilities and for others needing social services. Once again, these are not trips to flashy foreign destinations, but rather small outings, usually on chartered buses, to a local destination such as a museum or an outlet-mall. The primary purpose of the trip is to help forestall isolation by providing an opportunity for a group activity. Many of the individuals would not make the trip unless it is offered as a service by an organization with which the individual is familiar; in other cases, the individual would not be accepted by a commercial tour operator because of frailty or other special needs. Commercial carriers often are employed for the trip itself, although some organizations may utilize their own vehicles. The minimal impact these trips have on competition is far outweighed by their value to the individuals served. For that reason, trips for the elderly and disabled and for those needing social services should continue to be treated as a related activity subject to the community affordability test outlined for fitness activities.

Finally, many nonprofit human service organizations provide local transportation, with equipment acquired through federal grant programs and charitable contributions, to elderly and disabled persons and persons needing social services who are not served or are inadequately served by public transportation or whose physical limitations preclude the use of public transit. Individuals are brought to medical appointments, congregate meal facilities, senior citizen centers and similar destinations and returned to their homes. We do not believe that the subcommittee intended to affect this type of transportation service. The subcommittee should preserve the exemption for local transportation provided to carry on an exempt purpose subject to the general community affordability test outlined for fitness activities.

E. Adjunct Food Sales. The subcommittee should clearly exempt all food distribution services carried on in fulfillment of an organization's exempt purpose, such as distribution of food to the poor, the homeless and the homebound. The subcommittee also should exempt food sales to the general public where the sales activity is part of a vocational training program and no larger than necessary to carry on the program.

F. Veterinary Services. We have no comments on this point.

G. Hotel Facilities. The subcommittee should preserve the exempt status of hotel and residential facilities operated in fulfillment of an organization's exempt purpose so long as these facilities are no larger than needed to carry out that purpose. Nonprofit human service organizations operate a broad range of such facilities, ranging from shelters for battered women to single-room occupancy and overnight facilities, such as those still operated by many YWCA's and YMCA's. In all cases, the shelter is offered to persons who have difficulty finding adequate, safe and affordable shelter on the open market and to individuals in need of a sheltered environment.

Recently, some public housing authorities have begun selling public housing units to tenants. Similarly, some nonprofit organizations which have developed and rented housing to low and moderate income individuals, principally under section 202 of the National Housing Act, may seek to sell units to tenants and other low and moderate income individuals. Condominium sales should be exempt from taxation if they are part of a program to provide housing for persons of low or moderate income.

H. Routine Testing. The subcommittee should apply this provision only to laboratory testing. Many human service organizations provide a variety of tests that might be termed "routine" in the course of carrying out their exempt purpose. Examples include diagnostic testing for mental illnesses, vocational evaluation tests or physical fitness testing. Income from these tests should not be subject to tax.

I. Affinity Cards. Comments on this point are included in the section on the royalty exclusion.

J. Advertising. We have no comments on this point other than to urge the subcommittee to preserve the limited exemption for advertising that is substantially related to an organization's exempt purpose. Advertising job vacancies in a magazine circulated to affiliates of a national organization would be an example of advertising of this type, as would advertising the availability for purchase of affiliate publications and materials.

K. Theme/amusement Parks. We have no comment on this point.

L. Additional Specified Activities. We have no comment except to once again urge the subcommittee to avoid use of the term "inherently commercial."

II. Convenience Exception.

Repeal of the convenience doctrine would alleviate many of the complaints made by small business representatives at the subcommittee's hearings. Human service organizations accept the general principle that activities should be substantially related to an organization's exempt purpose to qualify for tax exemption.

III. Regularly Carried On Test.

We urge the subcommittee to consider very carefully the consequences of repealing this test. The current rule provides a clear-cut basis for exempting a variety of fund-raising activities. Repeal of that exception could lead to complicated analyses of sporadic, infrequent, or irregular fund-raising events to determine whether they are a trade or business and, if so, whether they qualify for exemption as activities substantially carried on by volunteers. Repeal carries a significant risk of taxing a major portion of donated income.

Most charitable fund-raising events would be characterized as a trade or business but for the fact that they are not regularly carried on. Selling cookies or candy, for example, is plainly a trade or business when conducted on a regular basis. If the exception for businesses not regularly carried on is deleted, the IRS will be forced to examine each organization's ratio of paid staff to volunteer time for each fund-raising activity to determine whether it is taxable or not. The resulting confusion would surely be far worse than the occasional need to litigate an isolated question such as whether an annual sale of greeting cards is a regularly carried on activity.

While most fund-raising employs substantial volunteer support, and some, such as charity auctions, also involves the sale of donated goods, all but the smallest organizations use paid staff in support of these activities. Volunteers plan the event, but paid staff may sell the tickets and paid staff generally will be be responsible for collecting all money. In some cases, such as benefit dinners, the organization also may employ paid musicians or other paid entertainment and may make payments to a hotel for the services of its staff. The volunteer exception permits some use of paid staff, since it requires only that "substantially" all the work be performed without compensation. However, what constitutes "substantially all the work" has never been fully delineated because the exception for intermittent and annual fund-raising events has relieved the IRS of the need to make these determinations.

We urge the subcommittee to preserve the current requirement that a trade or business be regularly carried on for tax to be imposed. The alternative either will be a burdensome case-by-case analysis or the imposition of tax on activities traditionally and deservedly regarded as exempt and which are not competitive with commercial activities.

IV. Royalty Exclusion.

The subcommittee also should retain the current royalty exemption for genuinely passive royalty arrangements. The subcommittee's proposal, which would effectively repeal most of the current exemption, represents a radical alteration of current law which generally provides for the exemption of passive income. Just as is the case for rents and other investment income, passive royalty arrangements provide important financial support for nonprofits without creating any potential for unfair competition.

As the subcommittee suggests, taxing net income royalties would be a useful step toward distinguishing genuinely passive from non-passive royalties. A further useful distinction could be made by enacting the principle found in a number of cases and revenue rulings that payments for the performance of services are not royalty income.

We are particularly concerned about the impact repeal of the royalty modification would have on an innovative way to raise money which a number of nonprofit human service organizations have adopted in recent years. These arrangements, known as cause-related marketing or charitable sales promotions, vary considerably in their details, but they are exemplified by an agreement under which a corporation advertises its support for a charity and agrees to make a contribution for each product purchased or coupon redeemed. Contributions from charitable sales promotions have helped some organizations replace federal funds lost since 1980.

Allowing the corporation to use the organization's name and logo in an advertising campaign serves two functions. First, it is a valuable way of educating the general public to the existence of the charitable organization and to the needs it serves, thereby boosting general public contributions to the charity. Second, it is a form of recognition for a corporate charitable contribution, similar in nature to listing corporate sponsors on programs for arts events, or naming a building or other facility for a substantial contributor.

Affinity cards are one form of charitable sales promotion. Whether income from affinity cards is taxable should depend on whether it is passive in nature, not on the fact that it stems from an affinity card.

The subcommittee should preserve the existing exemption for passive royalty income.

V. Deduction from Taxable UBIT.

We support increasing the present $1,000 UBIT deduction to $10,000. The subcommittee also should consider establishing a floor, say $10,000 of gross annual income, below which filing Form 990-T is not required. This change would help reduce the paperwork burden on small organizations.

VII. Taxable Subsidiaries and Joint Ventures.

We have no comment on this issue.

VIII. Allocation Rules.

Ordinary corporations are allowed to deduct depreciation and overhead costs from gross income. Nonprofits engaged in a taxable business activity should be allowed the same deductions. Any other rule would be unfair to nonprofits. The purpose of the unrelated business tax is to treat competitors similarly, not to penalize nonprofits for undertaking an unrelated activity.

IX. Tax Information Reporting.

Human service organizations support improved reporting of information concerning income-producing activities of nonprofits. However, to minimize the paperwork burden on nonprofits, we believe that information of this type should be reported on Form 990, not Form 990-T.

Human service organizations also support short-form filing for organizations with relatively small amounts of annual income. Generally speaking, smaller organizations are more heavily reliant on donated income than those with more resources and the preparation of detailed information returns is a heavier burden for smaller organizations. Correspondingly, larger organizations are more likely to have unrelated business income. Accordingly, we would suggest short-form filing for organizations with less than $500,000 gross annual income.

Members of the Grants and Contracts Project

American Red Cross
Boys Clubs of America
Boy Scouts of America
Catholic Charities USA
Child Welfare League of America
Council of Jewish Federations, Inc.
Family Service America
Girl Scouts of the U.S.A.
Goodwill Industries of America, Inc.
Lutheran Social Services System
The Salvation Army
United Way of America
Volunteers of America
YMCA of the U.S.A.
YWCA of the U.S.A., National Board.

MEMBERS OF THE NATIONAL ASSEMBLY
1988

AFL-CIO, Department of Community Services
American Association of Homes for the Aging
American Camping Association
American Red Cross
The Association of Junior Leagues
Big Brothers/Big Sisters of America
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Boys Clubs of America
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Travelers Aid Association of America
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United Way of America
VOLUNTEER - The National Center
Volunteers of America
YMCA of the USA
YWCA of the U.S.A., National Board

NACUBO 1988 25th Anniversary
National Association of College and University Business Officers
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April 15, 1988

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
United States House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515

**Re: Unrelated Business Income Tax:
Response to Discussion Options**

Dear Mr. Chairman:

The National Association of College and University Business Officers (NACUBO) appreciates this opportunity to respond to the Oversight Subcommittee's list of discussion options with regard to the unrelated business income tax. NACUBO is a national higher education association that represents more than 2,000 colleges and universities. We are deeply concerned with the financial and administrative well-being of higher education and it is in this particular light that we have prepared our reply.

Throughout this letter, we have highlighted a selected number of the proposed options that are of vital interest to college and university business officers. Although we have some overall concerns in terms of the tax and administrative burden, which adoption of these options could have on colleges and universities, we are limiting this response to the following discussion options: consideration of the "substantially-related" test; repeal of the "convenience" exemption; and allocation rules. We believe these selected options, if adopted, would place an unfair burden on colleges and universities.

We would be pleased to provide the Subcommittee with additional information on these issues if requested.

I. "SUBSTANTIALLY-RELATED" TEST

We have a particular concern about the changes proposed for the "substantially-related" test in light of the proposal to repeal the "convenience" exception. Sales and services provided explicitly for students, faculty, and employees, including housing, food services, and educational supplies, are now exempted under the "convenience" exemption, although it is understood that most of these activities would also meet the current "substantially-related" test were the "convenience" exemption eliminated.

However, it now appears, on the surface at least, that new restrictions to the "substantially-related" test (such as those listed below), coupled with a repeal of the "convenience" exception, could subject a significant amount of traditional educational sales and services to UBIT. We believe that this would have a very negative effect on many educational-related activities in that those sales and services provided for the educational community--offering little or no profit-making incentives for others outside that community-- would become subject to UBIT. This is an effect which we believe the Subcommittee may not have intended. We strongly urge that additional clarification and study of the effects be made before action is taken. We have noted below several of the more damaging proposals to restrict the "substantially-related" test:

A. "Directly-Related" Test

We understand that the intent of a "directly-related" test is to tighten requirements on what is considered unrelated and what is not. However, we believe the use of the term "directly" will cause confusion and uncertainty and may lead to unnecessary, excessive and harsh treatment of many educational activities. If the term "directly" is interpreted to mean 100 percent related, then the effort to tighten UBIT requirements would be carried further than necessary. We recommend that this option not be accepted.

B. Determining Whether Activity Standing-Alone Would be Tax-Exempt

Under current law, the "fragmentation" rule requires an item-by-item evaluation to determine if the activity contributes significantly to the educational purpose. This discussion option, however, would look at the activity independently as a trade or business to determine if it meets certain tax-exempt criteria. We believe that requiring such a determination is unreasonable for colleges and universities.

Many educationally-related support activities such as library duplication services--used solely to meet the needs of students, provide support for campus operations, and which are supported by tuition and fees--are undertaken only to accomplish the overall mission of the institution. There is no reason to examine them as if they would exist on their own, even if the college or university did not exist. We recommend that this option not be accepted.

C. Retain "Substantially-Related" Test But Establish A List of Exceptions

We support the retention of the current "substantially-related" test. We are concerned, however, with the indication that tax would be imposed on what is referred to as "inherently commercial" activities and how certain activities listed would be covered.

1. "On-Premise" Sales

The "on-premise" sale limitation refers to "off-premise" sales as being subject to UBIT. For educational institutions, we feel that it must be made clear that this does not apply, for example, to what are called "off-campus" activities such as educational instructional sites not located on a main or branch campus and where educational-related articles are made available to students.

2. Travel and Tour Services

Any exceptions to applying UBIT to travel and tour services should include services provided by colleges and universities in relation to administrative travel duties of faculty and staff as part of employment.

3. Advertising Income

The allowance for a deduction of direct advertising costs should include a prorated share of production costs such as those for paper and printing. It is assumed that the present IRS exception will remain for advertising sold by students in student publications and athletic programs.

4. Other "Inherently Commercial" Activities

As stated under item C above, we are concerned about the definition and application of the term "inherently commercial."

For example, parking lots, when looked at in isolation, might have the characteristics of an "inherently commercial" activity. However, parking lots on many campuses are not necessarily maintained as revenue producing activities, but to enable students and faculty to attend classes and use other campus facilities without restriction. In fact, because the majority of campus parking lots are operated as an integral part of the institution, they are often operated either on a break-even basis or at a loss. Moreover, the major reason for maintaining on-campus parking lots is for security purposes--general safety of students and employees. Providing adequate parking lot lighting and patrol services in order to maintain this security is a question of safety, not one of commercial intention.

Clearly, it would be unfair to set a commercial standard on all educationally-related activities without first considering how those activities relate to the overall mission, purpose and responsibilities of the institution.

II. REPEAL OF "CONVENIENCE" EXEMPTION

Earlier in these comments we referred to our concern over repealing the "convenience" exemption when combined with what we consider significant negative changes to the "substantially-related" test.

There are low-cost sales and service activities at colleges and universities now exempt under current law that should remain exempt. Examples include sales of personal items and school supplies, particularly at institutions located in rural areas, or where certain low-cost items are not readily available nearby. We would recommend that at a minimum, the "convenience" exception be allowed for items essential for the welfare of students on campus.

III. ALLOCATION RULES

When unrelated activities take place in campus facilities and are, therefore, subject to UBIT, a proportional deduction should be allowed for general overhead, depreciation, and operating costs. This is justified on the basis that if these activities are to be taxed at corporate rates, then that tax should be determined under similar corporate cost allocation rules.

In summary, it is our belief that the items noted in this letter are of critical importance to higher education in general and NACUBO members specifically. We believe that not only do our suggestions make for sound policy but would keep the cost of higher education to students at a minimum. Only by keeping costs as low as possible will this country be able to adequately provide access to higher education to all segments of the population.

Once again, we gratefully appreciate this opportunity to respond to this list of discussion options. NACUBO would be pleased to offer any additional assistance and information as requested by you and members of the Oversight Subcommittee.

Sincerely,

MJCalais

Mary Jane Calais
Director, Public Policy and
Management Programs

April 15, 1988

COMMENTS BY NATIONAL ASSOCIATION OF COLLEGE STORES IN RESPONSE TO HOUSE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE UNRELATED BUSINESS INCOME TAX ("UBIT") DISCUSSION OPTIONS

PRELIMINARY STATEMENT

The National Association of College Stores ("NACS") is pleased to submit these comments in response to the Oversight Subcommittee's request regarding various federal Unrelated Business Income Tax ("UBIT") discussion options presently under consideration. NACS fully endorses the comments and views adopted on this issue by the American Council on Higher Education. Nevertheless, throughout the Subcommittee's deliberations NACS has attempted to provide comprehensive, accurate information about college bookstore activities. In this vein, NACS wishes to submit separate comments here.

In its detailed August 5, 1987 submission, NACS emphasized several basic points which warrant repetition here. First, any change in present UBIT laws resulting in taxation of currently exempt campus services and activities would increase higher education costs at a time when students and their families have seldom been less able to afford such increases. Independently from any UBIT considerations, campus costs continue to rise faster than ability to pay for these costs. Any change in present UBIT laws which exacerbates this already undesirable situation should be avoided.

Second, college bookstores receive the overwhelming bulk of their revenue from sales of educationally essential items such as textbooks, other reading materials and school supplies. Sales of these items cannot reasonably support unfair competition claims against the campus bookstores, and as previously demonstrated to the Subcommittee, the actual number of complaints has in fact been minuscule. Moreover, it is important to note that textbooks, which generate by far the largest percentage of college bookstore revenue, are generally sold at exceedingly low (20-25 percent) margins. Some of the other bookstore merchandise is priced to subsidize these deliberately low textbook margins; and subjection of such merchandise to taxation beyond what present law requires could result in reduced sales of other items while likewise resulting in higher textbook prices.

Third, detailed financial information previously provided by NACS to the Subcommittee suggests that campus bookstores seem to be presently reporting and paying UBIT, as well as other taxes, when required to do so by law. Present UBIT law therefore appears to be working, at least when applied to the bookstores, and it is more than adequate to address any abuses. NACS questions whether there should be any change absent a showing that such change is clearly warranted.

Fourth, the diversity of American higher education makes it extremely difficult, if not impossible, to apply inflexible uniform federal taxation principles to all campus educational activities. The states and private campus trustee boards have traditionally determined when a given activity is educational in nature and thus constitutes an appropriate part of the campus mission. Any attempt to second-guess and then to penalize such decisions through federal tax law changes risks Congressional overreaching into this decision-making process. Present UBIT law avoids such a problem, however, by permitting IRS to review the unique characteristics of each campus to determine when a given product, service or activity is either substantially related to the campus educational mission as set by the state or campus governing board; or serves the convenience of the campus community to make achievement of that mission possible. Such a result seems consistent with Congressional intent in adopting the original UBIT laws, and any significant change could make it far more difficult for both Congress and higher education to attain their mutually desirable policy objectives.

Finally, the serious potential consequences of some of the suggested changes in present UBIT law require careful consideration before any such changes are made. Notwithstanding its other benefits, 1986 federal tax reform legislation has had devastating effects on U.S. higher education which are now being felt. As demonstrated in the August 5, 1987 NACS submission to the Subcommittee, saving for college and borrowing on student loans have become far more costly through the elimination of key deductions. Taxation of scholarships and fellowships is causing serious cost problems for those who need financial aid. Campuses are incurring far greater costs in financing their facilities and equipment purchases; while endowments have been severely penalized by making donations more expensive. The over-all impact of these changes, at a time when the United States needs more from its campuses than ever before to remain competitive in a global economy, is little short of traumatic. These adverse effects are reason enough to require further careful study of the actual fiscal impact of any further changes in federal tax laws affecting the campuses before their implementation rather than after their consequences are manifested.

It is with the foregoing points in mind that NACS submits its comments to the Subcommittee's proposed UBIT discussion options.

NACS POSITION ON PROPOSED UBIT DISCUSSION OPTIONS

I. "Substantially Related" Test

Substitution of a new "directly related" test for the "substantially related" test applicable under present UBIT law appears to be little more than a semantic difference absent any clarifying definition of either term. NACS has provided the Subcommittee with voluminous data showing that the overwhelming percentage of college bookstore revenues is derived from activities "directly related" to the campus educational mission as NACS understands this term. Since the "substantially related" term has acquired a body of legal precedent and interpretive decisions, however, it appears to NACS that a change in terminology could be disruptive without any compensatory benefits.

Insofar as college bookstore and other campus auxiliary activities are concerned, present UBIT law as applied by the IRS in Technical Advice Ruling 8025222 and interpreted in General Counsel Memorandum 35811 already appears to subject each such activity to the proposed "standing alone" discussion option test. NACS would merely caution that to the extent any such test were adopted, the activity at issue requires analysis within the context of how it contributes to the campus educational mission. Otherwise, some serious adverse economic consequences could result in the form of higher education costs.

NACS favors retention of the current "substantially related" test. Moreover, NACS believes that any attempt to redefine such a test on the basis of whether a given activity is "inherently commercial" is simply not workable. Virtually every campus activity, including many forms of classroom instruction, research and other laboratory activities, can meet an "inherently commercial" definition to the extent that private sector businesses can at least theoretically perform them for profit. This could be true even if no private business were in fact performing them, or if they are traditionally performed by the campus. Private sector involvement in a given activity should not be used to determine whether that activity is "inherently commercial." Adoption of such a test would needlessly penalize, through increased taxation-related costs, thousands of unequivocally legitimate tax exempt activities. No other test appears plausible.

SPECIFIC "SUBSTANTIALLY RELATED" DISCUSSION OPTIONS

A. Gift Shop/Bookstore Income

NACS agrees with the proposed UBIT applications to the bookstore activities cited in Example A. They do not appear to modify current UBIT law, as interpreted in the IRS rulings cited above, insofar as low-cost items and on-premise educational sales cited by the Subcommittee are concerned.

NACS severely objects, however, to any blanket taxation of "off-premise" sales. As drafted, this particular proposal could unfairly tax all educational activities, including textbook sales, at numerous NACS member bookstores located physically off a campus, especially those at satellite locations set up outside traditional campus boundaries to accommodate student convenience. In addition, the absence of available on-campus space has forced a number of college bookstores to locate a block or more off campus in commercial shopping areas. Taxing activities in such locations, which this proposal could at least arguably be construed to do, is simply inappropriate.

NACS objects to the "off-premises" proposal for two additional reasons. First, it unfairly penalizes the thousands of off-campus extension education students who often take courses in their workplace or satellite learning centers by taxing the sales of educationally essential items such as books or course-related supplies where the classes occur. Second, it seems to penalize students, faculty and staff who make credit card or other charge purchases over the telephone of educationally related items which should clearly remain tax exempt. Taken to its logical extreme, this particular proposal as drafted might even tax the sale by one campus bookstore of excess texts or educational supplies to deal with shortages faced by a campus bookstore elsewhere.

B. Medical/Pharmaceutical Laboratory Products

NACS believes that UBIT should not apply to the sale or rental income of any medical, pharmaceutical or laboratory products utilized either as part of a campus educational curriculum or which may serve the convenience health needs of the campus community. For example, this proposal as drafted appears to tax supplies sold in campus medical school bookstores, medicine for student patients in campus health centers, etc. We believe that this is inappropriate, as such sales unquestionably further legitimate campus educational goals.

C. Health/Fitness/Exercise Activities

UBIT should not be applied to revenue derived from health, fitness, exercise or similar activities engaged in by students, faculty or staff. In addition, this particular option appears to penalize legitimate campus extension activities often required by state law to be financially self-sustaining through course fees. Moreover, the "community affordability" standard suggested as an operative test appears to be unworkable in that "community" cannot be readily defined in most campus environments even assuming that "affordability" could be.

J. Advertising Income

This particular option could jeopardize the economic viability of numerous student publications which are financially marginal at best. Athletic program advertising revenue, which often funds indispensable educational activities, would also be reduced. In addition, taxing revenue on the advertising of tax-exempt educational products and services could increase the prices of those goods and services. NACS therefore objects to this option as proposed.

L. "Inherently Commercial"

As stated above, NACS does not believe that any "inherently commercial" test as applied to the campus is workable. NACS is also extremely concerned that the "additional specified activities" subject to this test may well constitute innovative educational services or programs which could be penalized under such a standard because of their innovative nature.

Other Discussion Options

Present law appears to apply UBIT to most if not all campus-related activities described in Options D (travel and tour services to non-students/faculty); E (adjunct food sales other than to students, faculty and staff); G (hotel income unrelated to campus curriculum); and H (routine testing unrelated to government programs or educational training). NACS has no comment on any of the other options cited under I.

II. Convenience Exception

NACS strongly opposes any repeal of the UBIT convenience exception. Congress enacted this exception into law many years ago precisely because a number of legitimate tax exempt activities which do not necessarily fall within the normal definition of "educational" as to their nature nonetheless facilitate the educational process. Students, faculty and staff at rural, residential suburban and even inner city campuses isolated from normal private sector commercial establishments could be especially hard-hit with such a repeal.

Although this particular Subcommittee discussion option appears conditioned upon adoption of most if not all the proposed options cited in Section I above, there is no assurance that all or even any of these other options will be adopted. Moreover, NACS has identified several instances where the Section I options are inadequate to avert an unduly harsh result. This would be especially true if the Subcommittee adopted a "directly related" test with the intent of excluding activities such as those listed in Option I.A which might otherwise merit tax exempt treatment. Finally, NACS would point out that items subject to the present UBIT convenience exception are often already sold at standard retail margins or higher to keep textbook prices down. Making such items taxable could therefore increase book prices as well as prices for these particular convenience items.

III. Repeal of "Regularly Carried On" Test

NACS has no view on this option.

IV. Tax Treatment of Royalty Income

To the extent that campus royalty income finances scholarships, academic programs, capital facilities construction or improvements and other activities fundamentally part of the campus mission, such income should remain exempt. In many instances, this proposal would increase the cost of consumer goods such as licensed insignia merchandise sold by the private sector since the campus would have to pass on the cost of any tax (and/or the costs of its calculation) to the off-campus licensee, which in turn would pass it on to the ultimate consumer. This option could ironically end up penalizing private sector merchants by forcing them to charge higher prices which would not necessarily be borne by campus providers of the same goods and services, since the latter are customarily excluded from any licensing fee requirements for activities at their own institutions.

V. Raising UBIT Deduction

NACS strongly favors raising the present UBIT deduction to $10,000. This could ease substantial administrative burdens for smaller campuses. The proposal to limit this deduction solely to activities directly carried on by the exempt organization would, however, unfairly penalize public campuses often required by state law to conduct numerous activities through one or more separately incorporated auxiliary entities. A specific allowance for this type of situation must be made to avoid a harsh result, perhaps through adoption of a "directly carried on" definition which encompasses non-profit subsidiaries or other entities wholly owned by the campus to conduct certain activities pursuant to state law.

VI. Unrelated Debt-Financed Income

NACS has no view on this particular option.

VII. Subsidiaries and Joint Ventures

At first glance these proposals appear to reflect an attempt to curb some perceived potential abuses in present law. In fact, however, they tend to penalize the creation of for-profit subsidiary corporations owned by non-profit, tax exempt entities at a time when the Subcommittee seems committed to strengthening the separate identification of tax exempt organization unrelated business income. Creation of such for-profit subsidiaries appears to be a very viable means of accomplishing this latter objective, since many tax exempt organizations might be far more likely to conduct their so-called "commercial" activities through for-profit subsidiaries than directly if there is an incentive for them to do so. Moreover, creation of for-profit subsidiaries for conducting such activities appears to place the non-profit, tax exempt entities and the private sector on a leveler competitive "playing field" than may presently exist without such subsidiaries. NACS therefore suggests that to the extent this option discourages the formation of for-profit subsidiaries, it should be carefully reconsidered.

VIII. Allocation Rules

NACS strongly objects to this option. It would have adverse economic effects, as well as unfairly penalize a number of NACS member bookstores required to finance their own capital facilities costs and pay all their own overhead expenses from store revenues. Numerous NACS member bookstores structured as non-profit, tax exempt cooperatives or in other non-profit forms finance most if not all their capital construction and overhead costs out of bookstore revenue or by borrowing against such revenue. To the extent such revenues are taxed under either present UBIT law or any proposed change, these entities should be permitted, like any other business, to deduct that portion of their capital facilities and overhead costs which is derived from gross unrelated income. Otherwise, certain bookstores could be forced to increase their prices, often substantially, to pay for this increased cost of continuing to function. It seems patently unfair and unjustified to impose a far heavier financial burden on exempt than on normal business organizations by not permitting the former to claim the same deductible costs as the latter on taxable income. As the scope of activities potentially subject to UBIT expands through any change in present law, this problem could increase substantially to the detriment of many valuable educational services.

IX. Increased IRS Reporting

NACS supports increased 990 and 990-T reporting requirements, subject to the recommendation that any new reporting forms and procedures be made as simple as possible to avert serious administrative burdens for smaller campuses. NACS likewise endorses those options which encourage more IRS studies and examinations of non-profit tax exempt activities as a means of gathering more data needed for sound governmental decision-making.

X. Miscellaneous

NACS generally favors increased codification in regulatory form of IRS rulings likely to clarify UBIT reporting and taxpaying responsibilities. NACS has no comment on any other proposed option in this category.

CONCLUDING STATEMENT

In reviewing the various Subcommittee options, it appears that most address problems which can be resolved under present UBIT law without statutory change. NACS believes that the Subcommittee should encourage IRS to implement these non-statutory changes. In addition, those options which do contemplate statutory change should be subjected to a stringent analysis of their financial impact before any are adopted.

NACS stands ready to continue working with the Subcommittee in these very important deliberations, and appreciates the opportunity to provide input at this time.

National Association of Exposition Managers, Inc.

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PLEASE ADDRESS REPLY TO:
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April 14, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

On behalf of National Association of Exposition Managers (NAEM) we wish to submit comments on the subject of the Unrelated Business Income Tax (UBIT) and the options proposed by the Subcommittee on Oversight (Ways and Means Press Release #16). NAEM is a 60 year old national, nonprofit organization comprised of exposition managers. Our members produce an aggregate of 4,000 trade shows, or nearly one-half of all major expositions in the United States.

We wish to comment on one specific discussion option, (e.g. "X. Miscellaneous: Consider modification of various piecemeal UBIT exclusions enacted since 1969.", P. 4 of Press Release #16). We understand that this option may apply to certain trade show, state fairs, etc., including convention and trade show activities and public entertainment activities of a qualifying organization now excluded by Section 513(d) of the Code, which is set out below:

> I.R.C. 513(d)(1) - General Rule.--The term "related trade or business" does not include...qualified convention and trade show activities of an organization described in paragraph (3)(C)...
>
> I.R.C. 513(d)(3) - Qualified convention and trade show activities.
> (A) Convention and trade show activity.-- The term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.
>
> (B) Qualified convention and trade show activity.--The term "qualified convention and trade show activity" means a convention and trade show activity carried out by a qualifying organization described in subparagraph (C) in conjunction with an international, national, State, regional, or local convention, annual meeting, or show conducted by an organization described in subparagraph (C) if one of the purposes of such organization in sponsoring the activity is the promotion and stimulation of interest in, and demand for, the products and services of that industry in general or to educate persons in attendance regarding new developments or products and services related to the exempt activities of the organization, and the show is designed to achieve such purpose through the character of the exhibits and the extent of the industry products displayed.
>
> (C) Qualifying organization.--For purposes of this paragraph, the term "qualifying organization" means an organization described in section 501(c)(3),(4),(5), or (6) which regularly conducts as one of its substantial exempt purposes a show which stimulates interest in, and demand for, the products of a particular industry or segment of such industry or which educates persons in attendance regarding new developments or products and services related to the exempt activities of the organization.

We believe that the Congressional legislative actions of the last two decades including changes in the Tax Reform Act of 1986 offer persuasive evidence that Congress finds trade show activities of nonprofits do serve a vital purpose. We do not believe, therefore, that Congress should so quickly reverse its direction on this specific point.

Associations produce expositions to achieve various objectives, such as:

1) Display latest products of an industry to the public, potential users, and manufacturers;

2) Disseminate information;

3) Encourage scientific thinking that leads to new product development and improved standard of living; and,

4) Foster global trade.

Motivated by these objectives, associations were a natural catalyst to spur the growth of trade shows in this country. In fact, associations, by their very purpose, initiated the early interest and growth in trade shows. It was an ideal way for an association of whatever description to serve its membership and the general public with a universally approved activity. Not surprisingly, associations began to develop professional exposition staff who specialized in trade show management. Indeed, when NAEM was founded 60 years ago, it was, and remained, for nearly four decades a 501(c)(6) organization comprised of members exclusively from tax exempt organizations. It wasn't purposely established to be exclusive; however, the membership reflected the fact that tax exempt association staffs were mainly involved in trade show activity.

There is no doubt that trade show income is an indispensable and growing part of the financial well being of associations. Since many of the activities of an association are not financially self-sustaining, the activity of trade shows help underwrite such diverse activities as the educational, public information, scholarships, safety and industry standard programs which don't have a measurable dollar return and more often than not, constitute a significant dollar cost for an organization.

We submit that Congress intended to shield this kind of activity income from taxation. Otherwise, it would be impossible for us to fulfill our purpose of contributing to the educational and research activities that ultimately touches the life of every American. Congress intended to leave untaxed the income from a trade show produced by a tax exempt organization so long as its production is related to the organization's exempt purposes. Over the years, this income has been the subject of disparate treatment by the IRS. The passage of the Tax Reform Act of 1986 offered an encouraging development because Congress finally provided a clear, legislative mandate to the IRS to consider this income outside the scope of the unrelated business tax. This clarity was not always present as the legislative history will show.

Prior to, and following the passage of the Unrelated Business Income Tax (UBIT) law in 1950, the IRS would on occasion challenge the tax-exempt status of an organization which sponsored trade shows. The IRS did not rationalize its activities as Congress did in passing the 1950 amendment on the basis of unfair competitive advantage of tax-free entities with their taxable competitors. Instead, the Service relied on the more traditional grounds that this income inured to the benefits of particular member-exhibitors and not to the industry generally. This inurement to members was cited often as the grounds for revocation or denial of tax-exempt status.

In the ensuing years following the enactment of the UBIT, the IRS paid only lip service to the congressional criteria that the activity in question (i.e., trade show income) be related to the organization's exempt purposes. This fact was confirmed by a recent GAO Report which stated: "IRS officials said that the relatedness criterion often makes the UBIT difficult to administer because there are no concrete rules for determining relatedness of income-producing or commercial activities to an organization's exempt purpose." The IRS' failure to apply the literal language of the statutory tests provided neither consistency nor predictability to tax-exempt organizations which produced trade shows.

In 1967, the IRS issued regulations attempting to correct this problem with regard to trade show income by focusing on what constitutes "relatedness." For the first time, the Service conceded that trade shows sponsored by 501(c)(6) organizations could be related to the organization's exempt purposes when the shows stimulated demand for an industry's product. However, the IRS left two significant issues unresolved involving "selling shows," (order taking and sales) and "supplier shows" (the majority of exhibitors are non-members of the sponsoring organization).

Eight years later in 1975, the IRS issued a series of controversial revenue rulings, which determined that any trade shows that allowed sales activities would generate taxable income. The tax-exempt portion of the trade show industry immediately protested these unpopular rulings to Congress and successfully urged the Congress to specifically exempt "conventions, annual meetings, and trade shows" activities of Section 501(c)(5) and (6) organizations by establishing a "safe harbor" test to insure that trade show income would remain untouched.

The safe harbor established that as long as the following conditions were met, a 501(c)(5) and (6) organization will be protected:

1) It must be conducted in conjunction with an international, national, state, regional or local convention conducted by a qualifying organization;

2) One of the purposes of the organizations in sponsoring the activity must be the promotion and stimulation of interest in, and demand for, the products and services of that industry in general; and

3) The show must be designed to achieve such purpose through the character of the exhibits and the extent of the industry products displayed.

One last anomaly remained to be corrected. The 1976 legislation and the implementing IRS regulations published in 1983 only dealt with 501(c)(5) and (6) organizations. The "safe haven" protection was not available to 501(c)(3) and (4) organizations. For them, the IRS continued to use its controversial rationale contained in its 1975 revenue rulings. After repeated efforts in Congress to correct this disparate treatment, it was finally accomplished in the Tax Reform Act of 1986. (See Section 1602(b), Public Law 99-514)

Expositions are activities engaged in by both for-profit and not for-profit sectors, but there are significant differences between the objectives of trade show management who are nonprofit and those who are taxable entities. Associations usually serve single-focused industries or professions, while the private exposition entrepreneur is free to pursue business opportunities wherever they may be.

Ironically, because expositions were conducted on a relatively infrequent basis, some associations made an economic decision to encourage its professional trade show staff to become independent. Thus, taxable entities were spawned by tax exempt groups, and almost without exception, the large, private exposition management firms in America today owe their existence to an earlier connection with a tax exempt organization. A significant number of trade shows are today owned and organized by for-profit companies, many of whom are publishing companies. This percentage has increased steadily during the last ten years offering incontrovertible evidence that the for-profit sector does not operate at a disadvantage in the exposition marketplace.

In conclusion, we respectfully urge that the subcommittee dismiss further consideration of the option to modify this important UBIT exclusion. The long, specific history of Congressional oversight of convention and trade show activity confirms both the validity of the justification for the current treatment and that this is not an unfair competition issue. Thank you for the opportunity to present our views.

Sincerely,

Donald J. Walter

Donald J. Walter, CEM
Executive Director

DJW/cab

April 15, 1988

Mr. Robert J. Leonard
Chief Counsel
House Committee on Ways and
  Means
1102 Longworth House Office
  Building
Washington, DC 20515

Dear Mr. Leonard:

The following comments on the discussion options relating to unrelated business income tax are filed on behalf of the National Association of Independent Colleges and Universities (NAICU) pursuant to your press release of May 31, 1988. NAICU represents over 800 private colleges and universities, ranging from large research universities to small religiously affiliated colleges. Our members care deeply about the preservation of the value of their tax-exempt status and thus are concerned about the manner in which this Subcommittee proposes to distinguish between tax-free and taxable activities.

Our comments today are not exhaustive because the timeframe for comments was inadequate to permit collection of information across the broad array of topics noted in your press release. We support fully the comments which will be filed by the American Council on Education (ACE) and the Independent Sector (IS), and urge you to consider the serious concerns raised in these comments by these two representatives of colleges and universities and the nonprofit sector.

We do which to emphasize several points:

1. The elimination of the convenience exception will leave many of the student support services which are part of the residential life of colleges and universities in a vulnerable posture. The following activities which are typically provided at campuses need special attention: dormitories; eating facilities; coin-operated laundries; soda and snack services; campus bus services; student and faculty parking; and student health and counseling programs. As you know the exception was created with full recognition of the difficulties that could arise with such campus life programs, hence special statutory language to prevent campus-by-campus audits. Without a specific exception deeming these services to be related, any campus could be told by an IRS agent that some or all of these activites are not related enough to their educational mission. Narrowing the exception, as we have stated previously, is acceptable to us; however, its elimination and subsequent reliance on the relatedness standard alone (or some even less generous undefined standard) is not.

2. We are very concerned with the proposal to use an "inherently commercial" standard in evaluating whether nonprofit activities which generate income are taxable. The Subcommittee's press release indicates that, if the "substantially related" test is preserved, tax might be imposed on specified activities "whose nature and scope are inherently commercial, rather than charitable". We are troubled by this approach. Of greatest concern to us is the backdoor use of a "commerciality" standard which is never defined. A review of the items included in the list does not help, for it is impossible to identify any unifying theme. This leads us to fear that this is a complaint list, rather than a conceptual standard. As such it would be available to be expanded to accomodate vocal business groups. We consider such a piecemeal approach to be a dangerous policy change.

3. NAICU members also are concerned with specified activities which would be taxed even if related. In each case, the message is that activities which are educational would nonetheless be deemed to be subject to UBIT. We take issue with such generalized conclusions pertaining to:

Advertising: The proposal is to subject to UBIT all advertising, including related activities. This would affect student newspapers, alumni publications, sports announcements, and special student projects. Such a change ignores the essentially educational qualities of these activities.

Off-Premises Sales from Bookstores: The distinction between on-campus and off-campus sales sounds imminently reasonable until one examines the range of campus and educational programs which would be affected. It is counterproductive to apply a tax on educational activities which are made available in places other than on the campus. We are particularly concerned about the implications of such a rule for the sales of university press publications, which are predominantly off-campus, and for sales in support of off-campus classes.

Medical Equipment and Devises: The attempt to distinguish between inpatients and outpatients creates parallel problems in the health context. Health care continues to move in the direction of alternatives to hospital care, both to reduce costs and to respond to the needs of the elderly. This will become even more important as AIDS patients grow in number. If concepts like "continuous care" are used, they need to be defined with sufficient flexibility to permit nontax, medical judgements to prevail in the provision of healthcare services.

Both ACE and the Independent Sector develop well the concerns of our membership with the proposed revisions to other sections of the UBIT. NAICU members are particularly distressed with suggestions to tax different types of royalty arrangements. We would remind you again of the serious consequences of hindering the transfer from academia of new developments and materials, so-called technology transfer. We believe that the proposals made in this paper would impede the availability of new, breakthrough techniques for commercial development and application.

In general, our members can support a number of the changes described, such as the increased reporting requirements, the redefinition of control from 80 percent to 50 percent; the taxation of hotels, veterinary services, and affinity cards; and the increased deductions from UBIT. Of course, the options are described in a general non-legislative manner and we would need to carefully review definitions and terms for the predictable problems which occur when drafting or revising such a complex area of the law.

If it would be helpful to the Subcommittee we would be willing to provide witness on these proposals.

Sincerely,

Sandra H McMullan

Sandra H. McMullan
Executive Director for Tax
Policy and General Counsel

STATEMENT ON
DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX
BY THE
NATIONAL ASSOCIATION OF INDEPENDENT SCHOOLS
AND
THE INDEPENDENT EDUCATION FUND

The National Association of Independent Schools (NAIS) and the Independent Education Fund (IEF) welcome this opportunity to comment on the Oversight Subcommittee's options relating to the unrelated business income tax (UBIT). We are concerned about the implications of shifting from a "related" standard to a "commercial" standard, and we would like to call attention to two specific issues -- the "regularly carried on" test and allocation rules.

NAIS and IEF are tax-exempt voluntary organizations whose membership is made up of 900 independent elementary and secondary schools with 350,000 students throughout the country. The schools are coeducational and single sex, boarding and day, nontraditional as well as experimental. They range in size from 36 to 3,500 students, and their founding dates go back to 1638. Membership is limited to schools that have racially nondiscriminatory admission and employment practices.

Most independent schools do not receive direct federal aid. Consequently, the schools are almost entirely dependent on charitable giving and fund-raising activities for support over and above tuition revenues. Annual or one-time events such as charity auctions, dances and benefit performances provide a crucial source of support for scholarships, faculty salaries, and other special programs.

NAIS and IEF recognize the concerns of the small business community. Charitable fund-raisers, however, do not compete with for-profit activities in most instances. In fact, they are supported extensively by the generosity of local businesses that donate items to be sold or auctioned.

The proposal to limit deductions for overhead and depreciation on facilities used for exempt purposes as well as unrelated business purposes would have an equally detrimental effect on independent schools. Representatives of nonprofit organizations are correct in arguing that exempt organizations would end up paying heavier taxes than comparable taxable businesses. Incentives for making the most efficient use of existing plants and buildings would be removed.

The proposed UBIT changes come at a time when changing patterns of family life and recent revisions in the tax code are making fund-raising more difficult. Repealing the "regularly carried on test" would compound this uncertainty by placing an unnecessary burden on benign revenue activities. We urge the Subcommittee to make every effort to protect innocent activities that contribute to the financial health of independent schools.

April 15, 1988

Comments of
The National Association of Public Television Stations
to the
Subcommittee on Oversight,
Committee on Ways and Means
on
Discussion Options
Relating to the Unrelated Business Income Tax

I. Introduction

The National Association of Public Television Stations (NAPTS) hereby submits its comments on the Discussion Options contained in Press Release #16 of the Subcommittee on Oversight of the Committee on Ways and Means released March 31, 1988.

NAPTS very much appreciates the opportunity to comment on the Oversight Subcommittee's discussion options at this early stage. NAPTS is a private, non-profit membership organization whose members are this nation's public television stations. These stations are all locally-controlled, not-for-profit organizations which derive most of their financial support from local and state contributions, federal funds and individual and corporate donations. NAPTS supports planning, research and representational activities on behalf of its members.

NAPTS concurs with the general comments submitted by Independent Sector, of which NAPTS is a member, in response to the Oversight Subcommittee's press release. The purpose of this submission is to highlight for the Subcommittee several areas in which the discussion options, if implemented, would have a potentially devastating impact on our member public television stations' ability to fulfill their congressionally-mandated sole mission of delivering alternative educational and public television programming to all Americans.

In reviewing our concerns, we urge the Subcommittee to bear in mind that the nation's public television system exists because of long-term, consistent Congressional support. Congress, by acting to reserve channels for non-commercial educational televison in 1952, by enacting the Public Broadcasting Act of 1967 to ensure a service that "will constitute an expression of diversity and excellence and will constitute a source of alternative telecommunication services for all citizens of the Nation" and by making an investment in public television of over $1.5 billion over the years, has stated loudly and clearly that the government and the American public have a strong interest in the continued existence of a strong public television system.

Over the past decade, the Congress has expressly directed the public television system to maintain a certain level of self-support. For example, the Public Broadcasting Act, as amended, requires distribution of certain Federal funds to public television stations on the basis of a formula designed to "maintain existing, and stimulate new, sources of non-Federal financial support for stations by providing incentives for increases in such support." 47 U.S.C. §396(k)(6)(B)(ii). In discussing the need for non-Federal support of public broadcasting, the House Committee on Energy and Commerce expressly stated that "in order to encourage and promote the generation of new support to public broadcasting, the Committee fully recognized the need to facilitate income-producing activities on the part of public broadcast licensees." House Report No. 97-82 (May 19, 1981) on the Public Broadcasting Amendments Act of 1981. Moreover, since 1981, public television stations have been expressly authorized to "engage in the offering of services, facilities or products in exchange for remuneration." 47 U.S.C §399b. Public television has taken these instructions to heart.

The Subcommittee should be certain that it recommends no action which might undermine Congress' goal of greater self-sufficiency for public broadcasting.

II. Specific Issues of Concern to Public Television

Several of the Subcommittee's Discussion Options, if implemented, would have a potentially devastating impact on public television stations. The issues of greatest concern to the local stations are the following:

a. Taxation of fund-raising activities;
b. Taxation of passive royalty income; and
c. Permissible deductions in computing taxable income from advertising in guides and other sources.

We also discuss certain other proposals of concern to public television.

We urge the Subcommittee in refining its Discussion Options to make sure that its recommended changes do not sweep too broadly. Whatever abuses may occur in isolated areas of the not-for-profit sector can be corrected either by more vigorous enforcement of current law or by narrowly drawn remedies, such as repeal of the "convenience" exception, designed to correct actual abuses. These actual abuses could thus be corrected without crippling entities, such as public television stations and producers, who have consistently operated in the public interest with no history of abuse.

a. Fund-Raising Practices

Although the discussion options are not sufficiently detailed to evaluate fully their impact on public television stations' fund-raising activities, Option I(A)(off-premises sales), Option III (repeal of "regularly carried on" test), Option X (elimination of exemption for "low-cost articles") have caused concern among public television stations. The Subcommittee should not unnecessarily handicap public stations' fund-raising efforts, which are their greatest source of support.

In any public television fund-raising drive, the critical motivation for the donor is his/her intent to make a donation to the station, not to "purchase" an incidental premium. Moreover, current law already limits the deductibility of the contribution to the donor to the excess of his/her donation over the fair market value of the item received. This provides adequate protection against abuses.

B. Licensing Royalties

As a theoretical matter, royalties, whether based on net profits or other measure, are in fact passive income and should not be taxed any more than stock dividends should be taxed. As a practical matter, taxation of royalties as proposed in Option IV would have many unintended adverse effects on public television. Public television's concerns in this area are in three categories discussed below.

1. Revenues From Distribution of Programming

It is essential to the many producers of public television programming, both stations and independent producers, that revenues from the ancillary distribution of the programs they produce continue to be excludable from tax. First, it is entirely consistent with the public interest goals of these producers that their educational and entertainment programming be distributed as widely as possible, whether overseas, to the home video market or otherwise. Moreover, ancillary market revenues are not gravy; they are an essential part of the revenue base for the production of the very alternative programming that gives public television its distinct character. Without these ancillary revenues, public television stations nationwide would have considerably less programming available to them at considerably higher cost.

2. Companion Volumes

As part of public television producers' educational goals, it is not uncommon that a companion volume associated with a particular program or series be produced and made available to viewers. As with ancillary distribution of programming, these volumes are both related to public television's mission and important to producers' ability to produce the programming in the first place. NAPTS was gratified to see that the IRS apparently agreed with this position, under current law, in a private letter ruling holding that income from an arts book received by a non-profit organization for the promotion of art is not taxable as UBI. PLR 8811021. We urge that this sound policy be continued and stated expressly in any new legislation.

3. Children's Television Workshop Programming

NAPTS fully supports the comments of Children's Television Workshop (CTW) in response to the Subcommittee's Press Release. The entire public television system would be seriously harmed if CTW's income available for program production were to drop as a result of changed treatment of royalties and consequent crippling of CTW's ability to reinvest in new programming. Sesame Street and other CTW productions are a critical part of the programming mix for just about every public television station in the United States, and CTW's contributions to children's literacy and education are well-known and well-documented.

It is fortunate for all in public television that the success and wide recognition of the Sesame Street characters has made CTW able to finance about two-thirds of its program's costs through character licensing and other revenue-generating activities. These activities clearly support CTW's and public televisions exempt functions by making the nation's children more aware of the Sesame Street characters. The licensing arrangements are carefully controlled, we understand, to make sure that nothing is done that would be inconsistent with CTW's educational goals and the royalty rates charged to commercial product producers are commercially determined, meaning that competing product producers are not disadvantaged.

Managers of public television stations throughout the country are concerned that the proposed change in treatment of royalties would cause their local stations to have to pay significantly more for Sesame Street and other children's educational programming, and that there would be less such programming as a result.

C. Allocation of Expenses; Advertising in Program Guides and Other Unrelated Income

NAPTS can agree that revenues derived from commercial advertising in our stations' program guides should be subject to Unrelated Business Income Tax, so as to avoid unfair competition with other guide publishers who sell advertising. By the same token, it seems only fair that our public television stations be able to calculate deductions in the same way taxable entities compute deductions for comparable publications. Specifically, to limit a non-profit's deductions against UBI to its "direct advertising costs" (Option I(J)) would be terribly unfair. Like any guide publisher, the public television station should be entitled to deduct the cost of the readership content of the publication and a reasonable allocation of overhead in computing tax owed.

The same principles hold true for any facilities of public television stations used for unrelated business purposes. Section 399b of the Public Broadcasting Act contains specific provisions on the proper allocation of costs of and revenues from such uses. 47 U.S.C.§399b. Option VIII, prohibiting deduction for general overhead of the organization or for depreciation where facilities are used for exempt and unrelated purposes, would unfairly put non-profit organizations in a far worse position than the very for-profit enterprises who are arguing for parity. It would also arguably conflict with the Public Broadcasting Act. For example, television facilities require expensive capital equipment which is subject to technological change. The net profit from unrelated business use of facilities would be materially overstated if allocated depreciation was not deducted.

D. Other Issues

1. Affinity Credit Cards

While these are not currently a huge source of support to public television, there is growing interest among NAPTS member stations in this potential resource in their efforts to maintain a level of self-sufficiency as directed by the Congress. In the case of an affinity credit card benefitting a public television station, the clear intent of the credit card user is to cause a charitable donation to be made to the station by selecting that particular credit card. There is no logical basis for treating this any differently from any other donation of money or property. Moreover, from the station's point of view, the income is passive income, like portfolio income, which the station received because of the station's charitable character.

2. Travel and Tour Services

These are sometimes used by public stations in conjunction with fund-raising efforts. Where a trip is a premium in a fund-raising drive, it should not be subject to UBIT as discussed in Paragraph A above. Such a premium would be deductible to the donor only to the extent of the excess of the contribution over the fair market value of the trip.

III. Conclusion

While we understand that the Subcommittee's proposals are not revenue-driven, we urge the Subcommitte to consider in the case of public television that any decrease in the ability of the public television system to support itself will have to be taken up by other sources. With the removal of the deductibility of charitable contributions for non-itemizing donors, it seems likely that at least some of the slack would have to be taken up by federal appropriations. Thus, the largely unanticipated effects on public television of some of the Subcommittee's Discussion Options might contradict and undermine longstanding Congressional support of a strong national public television system.

Respectfully submitted,

National Association of
Public Television Stations

Martha Malkin Zornow
Deputy General Counsel

EP3:2

COMMENTS OF THE NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS

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SUBCOMMITTEE ON OVERSIGHT,
COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES

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April 15, 1988

Re: Discussion Options Relating to the Unrelated Business Income Tax; Option VI., Relating to Debt Financed Income and Retention of Character of Debt Financed Income From All Pass Through Entities.

INTRODUCTION

The following are the comments of The National Association of Real Estate Investment Trusts, Inc. (NAREIT) regarding the subject discussion option of the Subcommittee on Oversight that proposes to extend the debt financed income rules for tax exempt organizations to "all pass through entities." NAREIT is writing to express the deep concern of the real estate investment trust (REIT) industry, because we understand that the option is intended encompass REITs and the Subcommittee may consider at this time to recommending legislation that will alter the character of dividends paid to tax exempt shareholders in real estate investment trusts.*

While REITs exist primarily for the benefit of individual investors who make up the vast majority of REIT shareholders, they provide an important opportunity for tax exempt organizations to obtain a transferable security interest in a portfolio of real estate assets, and thereby to assist REITs in performing their function of raising capital to support economically viable real estate activities. Among tax exempt organizations investing in REITs, the most prominent are pension plans, individual retirement accounts (IRAs), and other qualified retirement plans. Other investors include educational institutions, foundations and other institutions.

SUMMARY OF CONCERNS

Any proposal to change the taxation of REIT dividends to tax exempt organizations raises the following major concerns:

FIRST, it would be fundamentally inconsistent with the corporate entity principles central to REIT tax policy;

SECOND, it would be disruptive to all investors in REITs, both tax exempt organizations and individuals;

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*NAREIT is the national trade group for the REIT industry. According to NAREIT records, the industry is comprised of 161 tax qualified REITs, with total assets of $34 billion. Of these, NAREIT includes as its members 111 REITs with assets of $22.7 billion. Also included among NAREIT's members are more than 200 law, accounting and other firms with a continuing interest in the activities of REITs and the REIT industry.

THIRD, it would be disruptive to the flow of capital to the economically viable real estate activities in which REITs invest and will compel a notably underleveraged industry to become more dependent upon debt financing;

FOURTH, it threatens substantial complexity and problems of administration;

FIFTH, it would add to confusion and uncertainty over the direction of federal tax policy regarding pass through entities, especially those engaged in real estate activities.

For these and other reasons set forth below, any analysis of the treatment of REIT dividends must entail the most careful consideration of a wide array of concerns. Many of these concerns relate to the unique tax regime for REITs and the evolving tax policy with regard to publicly traded partnerships, widely held partnerships and other pass through entities investing in real estate. If a review of treatment of REIT dividends is to be considered at all, it should be done in the context of a comprehensive review of all pass through entities engaged in real estate activities. Accordingly, NAREIT strongly urges the Subcommittee on Oversight to refrain from recommending any changes as to the taxation of REIT dividends.

THE REIT IS AN UNIQUE ENTITY, SEPARATE AND ESSENTIALLY CORPORATE IN NATURE

REIT Organization and Taxation

A REIT is a corporation or an association taxable as a corporation which elects to be taxed pursuant to provisions in subchapter M of the Internal Revenue Code (Code). As contemplated by Congress when it enacted those provisions, the REIT provides a means for investors to participate in a diversified portfolio of real estate assets under professional management, while enjoying the benefit of investment liquidity represented by transferable securities having the attributes of corporate stock.

In a manner similar to the law applicable to regulated investment companies, or mutual funds, the Code requires a REIT to distribute 95 percent of its ordinary income to shareholders in the form of dividends, but permits the REIT to take a deduction for the dividends paid. If a REIT realizes capital gains, it may distribute the gains as such to shareholders and claim a deduction, or it may retain the gains subject to corporate tax at the REIT level. The dividend paid deduction mechanism does not allow a REIT to pass through deductions, losses or credits. Thus, a REIT is a form of hybrid or partial conduit that permits shareholders to derive income from certain activities free of entity level tax.

At the same time, the REIT retains its character as an entity separate and distinct from its shareholders. Preservation of the separate entity status of a REIT is evidenced in the longstanding Treasury Department policy dealing with REIT dividends when received by tax exempt organizations. Revenue Ruling 66-106, 1966-1 C.B. 151, specifically holds that REIT distributions to tax exempt organizations will be treated as dividends for purposes of Code section 512, regardless of the character of the income realized at the REIT level.

The separate or entity treatment of REITs has been recognized in a variety of other contexts. For example, when Congress included in the Tax Reform Act of 1986 the limitations on deductions from passive activities, it indicated in legislative history that, notwithstanding the passive real estate activities of REITs, REIT dividends should be treated as portfolio income rather than subjected to some type of look through to identify passive income.*

Availability of the deduction for dividends paid is conditioned on compliance with a series of organizational and operational tests designed in part to ensure that shares of a REIT are widely held, to require REITs to invest predominantly in real estate, and to prevent REITs from deriving profit from active business operations that are unrelated to the ownership or financing of real estate projects. The constraints imposed to ensure the essentially passive investment role of REITs include limitations on dealing in real property, a general prohibition against receipt of mortgage interest or rents based on income or profits of a borrower or tenant, and a requirement that a REIT engage an independent contractor to provide certain services to tenants. As a whole, this statutory regime severely limits the activity of REITs, precludes the pass through of active business income, and introduces a high degree of complexity into the operation of a REIT and its portfolio.

REIT Industry Concerns

Recharacterization of a portion of REIT dividends is fundamentally at odds with the REIT concept. While a look through to or the preservation of the character of tax attributes properly applies in the context of full conduits such as partnerships, it makes little or no sense in the case of REITs. We question how appropriate it is to attempt to treat a REIT as a complete conduit for the purpose of pass through debt of financed income, while retaining the partial conduit status of REITs for other purposes. To do so threatens a series of complex line-drawing exercises as other cases arise in which the precise degree of pass through effect must be determined.

Furthermore, serious technical concerns arise as to how a pass through system based on a dividends paid deduction can be adapted to permit pass through of income and deductions, thereby assuring that a tax exempt shareholder is reasonably and fairly taxed on net debt financed income attributable to REIT operations. Fair resolution of such concerns threatens to add complicated rules to an already complex body of REIT tax law, as is further illustrated in subsequent comments. Given the inherently passive nature of REITs and the unique system of tax law applicable to REITs, the Subcommittee should proceed most cautiously with any initiative to overlay the debt financed income rules on the REIT tax regime.

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*It is noteworthy that adherence to the entity concept is more stringent for REITs than in the case of mutual funds. For example, the law permits mutual funds to pass through capital gains to shareholders even if gains are not distributed. Mutual funds may also pass through tax exempt interest as nontaxable income to shareholders, but REITs may not.

DISRUPTION OF THE MARKETPLACE AND ADMINISTRATIVE COMPLEXITY

REIT Capital Structure and Operation

Members of the REIT industry vary widely as to their forms of investment activity and their capital structure. Some REITs devote their attention exclusively to ownership of real estate, others invest only in mortgage loans, while still others engage in both practices. Some REITs may have as few as one or two assets, but many have dozens of investments in their portfolios.

As to capitalization, REITs show similar diversity. REITs may rely predominantly if not exclusively on the invested capital of shareholders to support their activities, or they may be more dependent on corporate indebtedness, mortgages secured by REIT assets, or other forms of debt financing to fund operations. In general terms, however, the REIT industry today is notable for its low dependence on debt financing, in marked contrast to practices in the early years of the industry's history and the current practices of most other corporate entities. Moreover, the disinclination to rely on debt financing is especially evident among those REITs that are most attractive to tax exempt investors, the REITs that emphasize ownership of property. Aggregate financial information for these "equity REITs" reveals an extraordinarily low ratio of total liabilities to shareholder's equity of 0.76:1.*

Ownership of REIT Shares

In keeping with the spirit and requirements of the REIT tax laws, the great majority of REITs are public companies whose shares generally are traded in established securities markets. As is normally the case in such markets, large blocks of REIT stocks are held by nominees or in "street name" for the benefit of actual or beneficial owners. Although the resulting layers of ownership significantly complicate the process of identifying and communicating with actual owners, NAREIT, investment bankers, securities analysts and others familiar with the REIT industry believe that the vast majority of REIT shareholders are individual investors.

We believe that tax exempt organizations own a relatively small percentage of REIT shares, perhaps as little as 10 percent and almost certainly not exceeding 25 percent. Most of this investment is represented by pension plans, especially small business plans, and individual retirement accounts (IRAs). Some educational institutions, foundations and other institutions are also involved. For these investors, the REIT offers a valuable means for diversifying their holdings, and particularly for IRAs and small pension plans, the only effective means of acquiring liquid, income-producing interests in real estate.

The level of tax exempt investment appears anomalous to some observers, because tax exempt organizations, like many individuals, are income-oriented investors that should be naturally attracted to REITs. However, the low volume of shares outstanding and low daily trading volume of REIT shares have deterred many tax exempt investors that demand deeper markets that facilitate easy accumulation and disposition of the large blocks of stock that they typically prefer. Tax exempt investment in REITs has also been frustrated by the Department of Labor's "plan asset" regulations (29 C.F.R. Sec. 2510.3-101), which effectively compel most tax exempt organizations to acquire REIT stocks in the public markets rather than through private placements or limited offerings.

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*According to NAREIT figures, 87 of the 161 existing REITs invest substantially in equity interests in real property. These 87 REITs hold $9.8 billion of industry's $34 billion in assets.

Securitization of Real Estate and Federal Tax Policy

The market for security interests in real estate has grown enormously in the 1980's. Much of the growth has been fueled by tax incentives, and has been well publicized, the Tax Reform Act of 1986 (1986 Act) has radically changed or eliminated many of those incentives. For many investors such as REITs who are income-oriented, not tax-motivated, the changes made by the 1986 Act have been welcomed. The shift in tax policy effectively supports investment opportunities and capital formation for economically viable real estate activity.

Notwithstanding these positive developments, REITs and others in the real estate and securities markets unfortunately have suffered severe dislocation as a result of the 1986 Act changes. In addition, adaptation to the changing environment has been frustrated by other legislative activity, in particular the adoption of special rules in the Revenue Act of 1987 (1987 Act) dealing with the publicly traded partnership (PTP), an investment vehicle operating as a partnership but with transferable ownership interests designed to be traded in established securities markets.

The 1987 Act makes some PTPs taxable as corporations, but endorses the pass through tax treatment of several types of PTPs, including those engaged in many real estate activities. This treatment is contingent in part on compliance with elements of existing REIT tax law incorporated into the PTP rules. PTPs enjoy important flexibility not available to REITs, such as the freedom to act as a dealer in real property and to manage property without engagement of an independent contractor to provide tenant services. The benefits of this flexibility are tempered somewhat by a requirement that the distributive share of partnership income shall be treated as unrelated business income by a tax exempt partner.

While formalizing the separate status of REITs and PTPs as real estate investment vehicles under federal tax policy, adoption of the PTP rules has increased uncertainty in the securities and real estate markets. This uncertainty is aggravated by the fact that Congress has directed the Treasury Department to study and report by January 1, 1989 on a wide range of issues related to taxation of publicly traded partnerships and partnerships whose interests are widely held but not publicly traded. Furthermore, there is continuing uncertainty as to the status of the study of pass through entities initiated by the Select Revenue Measures Subcommittee in June, 1986. The study contributed to the development of the PTP rules, but a portion of its agenda has not been addressed, notably, the announced objective of analyzing the participation of tax exempt organizations in partnerships and other pass through entities.

REIT Industry Concerns

Based on the foregoing, particularly emphasize our concern that REITs and the real estate and securities markets should not be subjected to another piecemeal change in the law affecting real estate investment vehicles. It is troubling that the discussion option follows a substantial legislative effort that imposed REIT type constraints on publicly traded partnerships. A recommendation to alter the taxation of REIT dividends would push the REIT concept, which has been enhanced by the 1986 Act, closer to the PTP rules. Such movement would come, however, without the benefit of a coherent, thoughtful review of the different policies and rules governing REITs and partnerships. Such a course of events, in turn preceded by the sweeping legislation in the 1986 Act, is disconcerting as a matter of tax policy development alone. More importantly, it threatens to exacerbate the confusion and disruption plaguing existing and potential investors in real estate-related securities.

Among other things, it may culminate in wholesale disinvestment by tax exempt organizations in REITs, with consequent depression of REIT share prices to the detriment of all remaining shareholders. There will also be material interruption of the flow of capital through REITs to the economically sound, productive real estate investments that REITs seek. Furthermore, faced with the prospect of assembling capital without tax exempt investment, REITs will be forced to seek additional debt financing, a most unfortunate result for a notably underleveraged industry. With the prospect of such dislocation, it seems imperative to us that Congress must find compelling reasons to proceed at this time with any effort to recharacterize REIT dividends.

We would also underscore again the difficult questions and potential administrative complexity associated with an attempt to integrate the debt financed income rules with the tax rules for REITs. For example, if both pension plans and foundations hold shares in a REIT, how will rules be crafted to ensure that the benefits of Code section 514(c)(9) relief for real estate investments flow to the pension plans but not the foundations? Complex problems also arise when one considers how to determine the extent of acquisition indebtedness, how to identify debt financed property, and how to quantify debt financed income and associated deductions when a REIT may have a diverse portfolio of assets and a variety of outstanding debt obligations in different forms. Resolution of such issues in a workable, fair manner threatens to impose extraordinary burdensome rules on a body of law that already is complicated and limits severely the scope of REIT activities.

With all of these considerations in mind, NAREIT firmly recommends that the Oversight Subcommittee and the Ways and Means Committee refrain from presently pursuing any recharacterization of dividends paid by REITs to tax exempt organizations. Instead, the matter should be pursued at an appropriate point in connection with a review of emerging tax policy regarding publicly traded partnerships, widely held partnerships, REITs and other pass through entities.

We wish to thank the Subcommittee for the opportunity to present these comments. We are anxious to work the Subcommittee and provide any further assistance to ensure the best possible resolution of the issues presented.

NATIONAL ASSOCIATION OF REAL ESTATE
INVESTMENT TRUSTS

By Charles R Gardner
Charles R. Gardner, President

Statement of the
NATIONAL ASSOCIATION OF REALTORS®
THE WORLD'S LARGEST TRADE ASSOCIATION

The NATIONAL ASSOCIATION OF REALTORS® appreciates the opportunity to submit public comments on various proposals contained in the "Discussion Options" document released by the Oversight Subcommittee concerning proposals to revise the rules governing the unrelated business income tax (UBIT) rules pertaining to tax-exempt organizations. Although we have previously discussed, both verbally and in writing, various proposals that had surfaced regarding proposed changes to the UBIT rules, we welcome the invitation to respond publicly to specific proposals that have been suggested by Members of the Subcommittee or by staff. We look forward to working with Members of the Committee on Ways and Means when it considers proposals to revise the UBIT rules in an effort to devise workable rules with which both tax-exempt organizations and the business community, especially small businesses, can function.

Initially, we wish to applaud the Subcommittee and Staff for the decision to exclude from the "Discussion Options" document a proposal to tax as UBIT the net investment income of trade associations. Last year, the proposal to tax the net investment income of trade associations as UBIT was contained in the House version of H.R. 3545, but was subsequently dropped from the Conference Agreement on the bill. We would strongly urge the Subcommittee to follow the decision of the Conferees on H.R. 3545 to reject a proposal to tax the net investment income of trade associations. To reiterate the thrust of testimony previously submitted to the Subcommittee last year, a proposal to tax the net investment income of trade associations would deal a harsh blow to trade associations which rely on the investment income of members' dues to support a variety of exempt activities carried on by a trade association. Moreover, the source of the investment income lies at the heart of a trade associations tax-exempt status -- i.e. -- namely, the dues paid by members of a trade association such as the NATIONAL ASSOCIATION OF REALTORS®. Furthermore, an exemption from tax for the net investment income of trade associations does not represent unfair competition with the business endeavors of the small business community, which has been one of the major concerns precipitating the Committee's review of tax-exempt organizations and the UBIT rules.

We also would like to commend the Subcommittee and Staff for including in the "Discussion Options" document two proposals that will provide an element of certainty and stability in the tax law for tax-exempt lenders which loan funds to real estate ventures. The first would exempt from the UBIT commitment fees received by tax-exempt organizations, such as corporate and union pension funds, that agree to loan funds used for various purposes, including real estate development. The second proposal would treat as passive rental income exempt from the UBIT contingent rents received through a prime tenant or sub-tenant. This proposal clarifies an area of ambiguity relating to the UBIT of tax-exempt organizations and is especially beneficial to developers of shopping centers in which the use of contingent rental income as a measurement for the interest yield to lenders is a common industry practice. And finally, although we question the philosophical rationale for a proposal contained in the "Discussion Options" document to require a 20% equity investment by a tax-exempt lender in order for the yield derived by the lender to remain exempt from UBIT, we view this proposal as a significant improvement relative to a proposal that had been discussed but was omitted from the "Discussion Options" document to tax as UBIT the income derived by a tax-exempt lender in connection with a loan that contained an equity-kicker feature. We urge the Subcommittee not only to reject a proposal to tax tax-exempt loans with equity-kicker features as UBIT, but to shun any proposal that would deter tax-exempt investments in real estate, which has become a primary source of capital to the real estate industry. In view of the loss of numerous tax incentives for real estate investments in the 1986 Tax Reform Act, this point cannot be overemphasized.

Before proceeding with our comments on specific proposals contained in the "Discussion Options" document, the NATIONAL ASSOCIATION OF REALTORS® feels compelled to express its concern regarding information, which has been brought to our attention, indicating that revenue derived from revisions to the UBIT rules will be applied to pay for revenue losing provisions in the Technical Corrections bill pending before the Committee. While rumors are rife in Washington and we do not wish to give credence or momentum to this suggestion, we must express our alarm at the possibility that such a scenario could materialize. The rules regarding the unrelated business income tax of tax-exempt organizations, which attempt to strike a balance between the needs of small businesses which deserve protection from unfair competition by tax-exempt organizations and the legitimate interests of the tax-exempt community, are far too important, we respectfully submit, to have substantive policy decisions in this area dictated, either directly or indirectly, by a need to raise revenue for provisions contained in the Technical Corrections legislation that are unrelated to tax-exempt organizations.

A. Comments on Specific Proposals in the "Discussion Options"

1. Proposal to Aggregate Activities of Taxable Subsidiary with those of Tax-Exempt Parent.

The "Discussion Options" document contains a proposal to aggregate the activities of the tax-exempt parent with those of the taxable subsidiary which it controls to determine whether the primary purpose of the tax-exempt organization remains "exempt in nature." A second proposal would redefine what constitutes control of a taxable subsidiary by a tax-exempt parent to require only that the tax-exempt parent own more than 50% of the stock in the taxable subsidary rather than the present law 80% requirement. And thirdly, the "Discussion Options" document contains a related proposal to disallow as a deduction in computing the taxable income of the taxable subsidiary any losses derived by the taxable subsidiary from the conduct or pursuit of an activity that was not engaged in for profit.

Although the NATIONAL ASSOCIATION OF REALTORS® does not oppose the proposed changes in the UBIT rules that would redefine control to be present where more than 50% of the stock of a taxable subsidiary exists or the proposal to disallow a deduction for losses derived by the taxable subsidiary from the operation of a nonprofitable activity, we strenuously object to the proposal to aggregate the activities and income of the taxable subsidiary with those of the tax-exempt parent in order to determine whether the primary purpose of the tax-exempt parent remains exempt in nature. If this test were not met, then the proposal would cause the tax-exempt status of the parent company to be revoked.

Although the "Discussion Options" merely allude to an aggregation of "income and activities of the subsidiaries and the parent organization" and it is unclear in what manner those items would be evaluated in determining whether the primary purpose test were met, this proposal, if adopted, would wreak havoc in the tax-exempt community and would adversely affect the tax-exempt status of many local REALTOR® boards affiliated with the NATIONAL ASSOCIATION OF REALTORS®. As we previously commented in correspondence dated March 28 to Members of the Ways and Means Committee, most of the local REALTOR® boards conduct their multiple listing service activities (MLS) through taxable subsidiaries. In those instances, the local board of REALTORS®, which, like the NATIONAL ASSOCIATION OF REALTORS®, is a 501(c)(6) tax-exempt, trade association, pays UBIT on dividends and other distributions received from the taxable subsidiaries, due to the fact that the local boards already control 80% or more of the stock of the subsidiaries. However, if the activities of the taxable subsidiary were aggregated with the activities of the tax-exempt local real estate board, it is unclear whether the REALTOR® boards could retain their tax-exempt status under Section 501(c)(6).

We believe that imposition of an aggregation rule as proposed in the "Discussion Options" would be extremely harsh in its effect, would create considerable confusion and uncertainty among trade associations and other tax-exempt organzations in their relationships with taxable affiliates or subsidiaries, and should be rejected. In those cases where the taxable subsidiary conducts a business functionally related to the exempt purpose of the tax-exempt parent and the tax-exempt parent already pays UBIT on distributions from the taxable subsidiary, a proposal to revoke the tax-exempt status of the parent organization appears to be a draconian approach to whatever problem that the Treasury Department or the Subcommittee may perceive to exist. It should be noted that even the Treasury Department indicated in its testimony before the Subcommittee last year that it was unaware of any cases in which a tax-exempt parent company had transferred a business unrelated to its exempt purpose to a taxable subsidiary in order to retain its tax-exempt status by circumventing the primary purpose test. In an effort to combat a non-existent, but admittedly theoretical problem, the proposal would only cause disarray in the tax-exempt community and should be emphatically rejected.

2. Proposal to Disallow Deduction in Computing UBIT for General Overhead Expenses and Depreciation.

The "Discusion Options" document proposes to disallow a deduction to a tax-exempt organization in computing its unrelated business income for general overhead expenses or depreciation where the facilities and personnel involved in pursuit of the exempt purpose are also used in connection with an unrelated business activity. Current law provides that general expenses and depreciation are to be allocated between an exempt purpose and an unrelated business on a reasonable basis. In its testimony, the Treasury Department commented that the allocation of expenses in the situation of a multiple use of facilities and personnel is amongst the most difficult issues that they face in determining the correct amount of a tax-exempt organization's unrelated business income.

The NATIONAL ASSOCIATION OF REALTORS® opposes the disallowance of a deduction for any portion of the overhead or depreciation in calculating an exempt organzation's unrelated business income. The proposal appears to emanate from statements by the Internal Revenue Service that certain tax-exempt organizations have excessively allocated overhead expenses and depreciation to their unrelated business activities, thereby reducing their UBIT liability. The proposal in the "Discussion Options" to disallow any allocation of overhead or depreciation to the unrelated business activity of a tax-exempt organization represents an extreme overreaction to whatever perceived problem may exist in this area. Instead of attempting to fashion a rule that would simply allocate overhead and depreciation between the tax-exempt and the taxable activity in those cases where a dual use of facilities and personnel was present, the "Discussion Options" would simply disallow any allocation of expenses or depreciation in the computation by the tax-exempt organization of its UBIT liability. If adopted, this proposal would essentially require tax-exempt organizations to compute its UBIT liability on a semi-gross income basis without the benefit of legitimate, reasonable expenses allocable to the conduct of the business activity. Such an approach would place the tax-exempt organization at a competitive disadvantage relative to taxable businesses engaged in the same or similar activities. If the Subcommittee indeed decides that a revision of the allocation rules in this area is warranted, we would strongly urge the Subcommittee to adopt rules that more precisely and reasonably allocate legitimate overhead expenses and depreciation between taxable and tax-exempt activities conducted by a tax-exempt organization.

3. Proposal to Replace for the "Substantially Related" Test With an "Inherently Commercial" Standard in Determining Whether UBIT Should Be Applied.

The "Discussion Options" document contains a proposal that would generally retain the "substantially related" test, but would treat certain specified activities as unrelated and "inherently commercial", thereby subjecting the income from those activities to the UBIT. On its face, the list of activities contained in the proposal that would be deemed "inherently commercial" is innocuous in its effect on the NATIONAL ASSOCIATION OF REALTORS® or its various affiliates or local boards. However, we are deeply concerned at the manner in which the list of activities deemed to be "inherently commercial" ostensibly was arrived at by the Subcommittee. Specifically, the areas identified as "inherently commercial" were those raised at that time by witnesses at the Subcommittee's June 1987 hearings without further evidence to support the allegations and complaints raised by the witnesses from the business community. In light of this background, the establishment of a new standard stressing the commerciality of particular activities run by tax-exempt organizations leads us to question whether the list of activities deemed to be inherently commercial is simply a reflection of the political strength of various groups that have raised their voices to Congress. This possibility is particularly troubling, since later additions could open the door for an extension of the commerciality test, based upon political considerations alone, in a manner adverse to real estate or trade association activities.

The NATIONAL ASSOCIATION OF REALTORS® believes that the "commerciality" test would only cause confusion and uncertainty among tax-exempt organizations regarding the application of the UBIT rules to its activities and functions. We also fear that a commerciality test could even be broadened to apply the UBIT to income derived from a tax-exempt organization's legitimate pursuit of its tax-exempt purpose. Support for retention of the "substantially related" test can be found in June 22 statement before this Subcommittee by Commissioner Lawrence Gibbs, who said, "... the Service would not recommend codifying 'unfair competition' as a statutory test which would preclude tax-exempt status. Currently, the Service does not have the data or the expertise to make decisions relative to whether or not there is 'unfair competition' in any particular case." We concur with Commissioner Gibbs and urge this Subcommittee, as well as the full Committee on Ways and Means, to continue to apply the "substantially related" test, with which both the Treasury Department and the tax-exempt community, have developed a working knowledge and familiarity.

4. Proposal to Tax as UBIT the Net Income Derived by Trade Associations from Trade Shows, Conventions, and Other Activities.

Under the heading "Piecemeal Exclusions of Certain Activities," the "Discussion Options" document proposes to repeal the exemption from UBIT for net income derived from certain trade shows, conventions, exhibits, seminars, and other activities. Examples cited in the document reveal that income derived by a trade association from sponsoring, endorsing, and providing the support services for an international commercial trade show, would be taxed as UBIT under the proposal.

The NATIONAL ASSOCIATION OF REALTORS® strongly opposes any proposal to repeal the exemption from UBIT for income derived by trade associations from activities involving trade shows, exhibits, seminars and similar activities. Section 513(d) of the Internal Revenue Code expressly exempts from the UBIT income generated by trade associations from convention activities, trade shows, exhibits, seminars, and similar events. The types of activities listed in this Code section are not only substantially related to the pursuit of the exempt function of the NATIONAL ASSOCIATION OF REALTORS® and other trade associations, but, in fact, are inextricably linked to the ability of a trade association to serve its members and their needs. Moreover, the activities exempted from the UBIT do not pose the slightest threat of unfair competition with small business, because the activities are designed and structured primarily for the benefit of trade association members only and would logically be conducted only by the trade association to which these members belong. Accordingly, the statutory exemption from UBIT for trade association income derived from trade shows, convention activities, exhibits, and similar events should be retained.

5. Proposal to Tax as UBIT the Net Income Received by a Tax-Exempt Organization from a Bank or Credit Card Company for the Use of Its Name or Logo on a Credit Card.

The "Discussion Options" document contains a proposal to tax as UBIT the net income received by a tax-exempt organization from the use of its name or logo on credit cards or mail order catalogs. The proposal would apply to royalty income received by a tax-exempt organization in those cases where its name or logo were used by a credit card company or financial institution.

The NATIONAL ASSOCIATION OF REALTORS® objects to the proposal to tax as UBIT the royalities or other net income derived by a trade association or other tax-exempt organization from the use of its logo or trade name on credit cards or mail order catalogs. Adoption of the proposal would represent an abrupt departure from the framework of taxation involved in the unrelated business income tax. The UBIT rules attempt to distinguish between the conduct by a tax-exempt organization of business operations, the income from which is taxable as UBIT, and the treatment of income derived from passive investments, which historically have been exempt from the UBIT, except in those instances where the passive income derived by the tax-exempt organization was indirectly derived through the conduct of a trade or business carried on by an affiliate or subsidiary of the tax-exempt organization. Section 512(b)(2) expressly exempts from the UBIT any royalty income "... whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income." In our judgment, there are no particular aspects associated with the transactions in question that justify distinguishing this type of royalty income from other royalty income that is exempt from the UBIT under Section 512. Once again, it would appear that the philosophical underpinning of this particular proposal rests on an unsound premise, and that the proposal merely reflects the complaints expressed by politically vocal business groups that seek to undermine the basic fabric of the exemption from UBIT for passive income, such as royalties, rents, etc.

6. Proposal to Revise Allocation Rules Regarding Advertising and Circulation Expenses.

The "Discussion Options" document contains a proposal to allow a tax-exempt organization to deduct from their unrelated business income derived from advertising activities only those direct advertising costs and to disallow a deduction for general circulation expenses. In the explanation and ensuing examples, the "Discussion Options" document indicates that only those costs that are directly connected with the sale and publication of advertising could be applied against advertising revenues in computing UBIT, while the excess of readership costs over general circulation income would not be deductible in determining the UBIT from a tax-exempt organization's advertising income.

The NATIONAL ASSOCIATION OF REALTORS® opposes this proposed modification for reasons similar to those that caused us to object to the disallowance of an allocation of overhead and depreciation in computing UBIT. The effect of a proposal to limit the deductibility of expenses against advertising income to direct advertising costs is to subject advertising income to a tax under the UBIT even if the publication with which the advertising activities are associated operates at an overall loss. This result places the publications of tax-exempt organizations at a competitive disadvantage under the tax laws relative to the tax treatment of commercial publications. The NATIONAL ASSOCIATION OF REALTORS® believes that this issue, like the question of an allocation between tax-exempt and taxable use of facilities and personnel, can be resolved administratively by the Internal Revenue Service. The result suggested in this proposal of disallowing the deduction against unrelated business income for all but direct advertising costs would operate indiscriminately and would cause advertising income to be taxed at a higher rate when compared with income derived from circulation or subscription revenues.

CONCLUSION

The NATIONAL ASSOCIATION OF REALTORS® appreciates the opportunity to present its comments to the Oversight Subcommittee prior to any final decisions by the Subcommittee regarding proposed revisions to the UBIT rules for tax-exempt organizations. We hope that the Subcommittee will keep our views in mind as it considers revisions to the UBIT rules, which are of immense importance to tax-exempt organizations and their role in society. Because of the importance that the treatment of tax-exempt organizations occupies under our tax system, we urge the Subcommittee and the Committee on Ways and Means, in the strongest terms possible, to consider any revisions to the UBIT rules separately without regard to a need for any revenue that the Committee may deem to be necessary to pay for proposed revenue losing provisions in the Technical Corrections legislation or elsewhere. In our judgment, the policy decsions involved in a review of the UBIT rules are far too important to be obscured or influenced by factors unrelated to the need to strike a balance between the treatment of tax-exempt organizations and the legitimate interests of the small business community in assuring fair competition in the market place.

PROPOSED OPTIONS (MARCH 31) RELATING TO THE UNRELATED BUSINESS INCOME TAX

STATEMENT OF JOHN M. RECTOR

BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT

APRIL 15, 1988

Mr Chairman, Members of the Subcommittee*:

I am John M. Rector. I serve as General Counsel and Vice President of Government Affairs for the National Association of Retail Druggists.

The National Association of Retail Druggists represents nearly 40,000 independent pharmacies, where more than 75,000 pharmacists dispense 70 percent of the nation's prescription drugs. Together, they serve 18 million persons daily and provide 82 percent of Medicaid pharmaceutical services. Over 60 percent of NARD's members provide home health care pharmacy services. NARD has long been acknowledged as the sole advocate for the proprietary and professional interest of this vital component of the free enterprise system.

NARD members are primarily family businesses. They have roots in America's communities. The neighborhood independent druggist typifies the reliability, stability, yet adventuresomeness that has made our country great.

---

* J.J. Pickle, (D-TX), Chairman

MAJORITY: (7-D) J.J. Pickle, Beryl F. Anthony, Jr. (D-AR), Ronnie G. Flippo (D-AL), Byron L. Dorgan (D-ND), Harold E. Ford (D-TN), Charles B. Rangel (D.NY), Andrew Jacobs Jr. (D-IN)

MINORITY: Richard T. Schulze (R-PA), Bill Frenzel (R-MN), William M. Thomas (R-CA), Raymond J. McGrath (R-NY)

As owners, managers and employees of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to provide them a fair change to complete. We appreciate the opportunity to submit our comments on the March 31,1988 proposals by the Subcommittee aimed at providing a level playing field and curbing current activities of non-profits which are commercial in nature unless they, like our members, want to pay the full cost of doing business in our economy. Needless to say today, April 15, is the day above all days when Americans focus on perceived and real inequities in the nation's tax code and the enforcement, or lack thereof, of its provision.

We commend Chairman Pickle, Ranking Minority member, Representative Schulze and the entire Subcommittee for your proposed options designed to reform unrelated business income tax obligations of nonprofit entities. We urge the subcommittee to include all of the proposed measures in your final report.

SUBSTANTIALLY RELATED TEST

The subcommittee proposal in this area is welcomed:

> " OPTION:
>
> Apply UBIT to income from sales or rentals or fees to outpatients and non-patients for medical equipment and devices, laboratory testing, and pharmaceutical drugs and goods. Income from sales, rentals or services provided to inpatients and continuous care or emergency treatment outpatients would be exempt. In addition, exempt from UBIT income from items where such items are not available from other sources in the immediate geographic area.
>
> Examples:
>
> UBIT would apply to income from the leasing of medical equipment, such as a wheelchair, the sale of an infant car seat, or the sale of prescription drugs to non-patients of a hospital or outpatients that do not require continuous care or treatment in the hospital.
>
> UBIT would apply to income from the sales of prescription drugs to non-patients, unless no other pharmacy can provide such services within the community.
>
> UBIT would not apply to income from sale of crutches to person treated at hospital emergency room"

Regarding "I. The Substantially Related Test" B, Subsection B, we recommend that any notion of "continuous-care outpatients" or "emergency treatment outpatients" follow the criteria established by the U.S. Supreme Court for delineating "own use" in the Abbott Laboratories, et al vs. Portland Retail Druggist Assoc. Inc., 425 U.S. 1,(1976) (Abbott vs. PRDA); and the provisions of and public policy established by the Prescription Drug Marketing Act, HR 1207, which the Speaker, on April 11, signed in its enrolled form and forwarded to the White House.

In the Abbott vs PRDA case, the Court established criteria delineating the non exempt use from the exempt use of prescription drugs for anti-trust purposes. In 1938 Congress reviewed its 1936 Robinson-Patman Act and discovered that they had constructed an eleemosynary disincentive, subsequently the 1936 Act was amended in order to accommodate eleemosynary pricing for nonprofit institutions.

The Court found it convenient to view nonprofit hospital sales and dispensations of pharmacy products in several categories. There were delineated (at pp. 6-7) as follows:

> "1) To the inpatient for use in his treatment at the hospital. For present purposes, we define an inpatient as one admitted to the hospital for at least overnight bed occupancy
>
> 2) To the patient admitted to the hospital's emergency facility for use in the patient's treatment there. A patient in this category may or may not become an inpatient as defined in the preceding paragraph. 3) To the
>
> 3) To the outpatient for personal use on the hospital premises. For present purposes we define an outpatient as one (other than an inpatient or a patient admitted to the emergency facility) who receives treatment or consultation on the premises.
>
> 4) To the inpatient, or to the emergency facility patient, upon his discharge and for his personal use away from the premises.
>
> 5) To the outpatient for personal use away from the premises.
>
> 6) To the former patient by way of a renewal of a prescription given when he was an inpatient, an emergency facility patient or an outpatient.
>
> 7) To the hospital's employee or student for personal use or for the use of his dependent.
>
> 8) To the physician who is a member of the hospital's staff, but who is not its employee, for personal use or for the use of his dependent.

> 9) To the physician who is a member of the hospital's staff, for dispensation in the course of the physician's private practice away from the hospital.
>
> 10) To the walk-in customer who is not a patient of the hospital

In delineating the "own use" test the Court dealt with the so-called take home prescription (*singular)* when they stated (at p.13):

> "We therefore conclude that the genuine take-home prescription, intended for a limited and reasonable time, as a continuation of, or supplement to, the treatment that was administered at the hospital to the patient who needed and now continues to need, that treatment is for the hospital's 'own use'".

And they stated further (at p.13):

> "We conclude however that the refill for the hospital's former patient is on the other side of the line that divides that which is in the hospital's "own use" from that which is not. Inevitably, in accord with the test above set forth, there comes a point where the dispensation of pharmaceutical products is not in the institution's "own use". That point, we feel is positioned short of the refill. Continuation of a drug's use for some time after initial prescription at the hospital may well be indicated for the particular patient, but except for the limited take home prescription referred to above, it is not the hospital's "own use," and it certainly is not for its "own use" forever just because it originated under hospital auspices...."

While finding that the walk-in buyer would not be exempt, the court did (at pp.15-16) "...recognize however, that there may be an occasion when the hospital pharmacy is the only one available in the community to meet a particular emergency situation. The respondent seeks to counter this possibility with a telephone book yellow-page reference to the providing of 24-hour service, and of some emergency or delivery service, by certain metropolitan Portland retail pharmacies Brief for Respondent 56. That may be. We are content however, to conclude that the occasional emergency is de minimis, in any event, and that its presence solitarily would not trigger litigation of the present kind. So long as the hospital pharmacy holds the emergency situation with bounds and entertains it only as a humanitarian gesture...."

In our view in todays market place uncompensated care and bad debt are the only remnants of charitable activities that most nonprofit entities can justify. When a nonprofit hospital provides prescription drugs to inpatients who are cash paying customers or covered by Third Party insurance whether public or private they are not serving an eleemosynary purpose. In other words to characterize Kaiser Permanente or AARP Pharmacy Services as eleemosynary is to make mockery of the concept.

The Prescription Drug Marketing Act, HR 1207 (which passed the House in May 1987, and the Senate on March 31st 1988)in its enrolled form was signed by the Speaker earlier this week, April 11, and sent to the President.

In the final hearing on this measure conducted by the Senate Finance Committee, the Chairman of our Legislative Committee, Calvin Anthony, Mayor of Stillwater, Oklahoma included the following among our concerns:

> "Typically our members, independent retail pharmacists, pay $9-10, depending on whether they purchase directly from a manufacturer or from a wholesaler, and a nonprofit hospital pays $1 for the same prescription drug. In the case of Transderm Nitro, the ratio is nearly 1 to 100. Unless wholesalers or retailers purchase prescription drugs that have been illegally diverted from nonprofit hospitals, such "discounts" are unavailable to them, irrespective of the volume purchase.

What is the extent of such sales? In a recent calendar year, manufacturer's sales of prescription drugs for human use in the United States totaled $15,393.7 million. Sales to hospitals, nonprofit and government, exceeded 20% of this total. Private hospitals, the overwhelming majority of which enjoy nonprofit status, held a 13.7% marketshare, with total purchases of $2,107.9 million.

Such pricing policies lend to phenomenal cost-shifting to the general public, created by the extraordinary low prices offered to nonprofit institutions purchasing prescription drugs.

The possible dimensions of cost shifting to wholesale and retail purchasers is best assessed when it is recalled that typical differential means that the retailers pay in the range of $10 for every $1 paid by a nonprofit hospital for the same product. Thus, in terms of the normal wholesale/retail marketplace, the value of such purchases by nonprofit hospitals could approach that of all sales prescription drugs. Think for a moment -- if even 50% of the hospital purchases were acquired at a 10 to 1 ratio, the 2.1 billion reported would convert in value to more than $10 billion.

Some major pharmaceutical corporations have a one-price policy. Recently, an additional major pharmaceutical corporation announced that it would significantly increase its so-called "bid prices". The corporation indicated that in moving towards a one-prize policy, they hope to minimize the present competitive disadvantages to retail pharmacies and their patient/customers, who presently experience frequent price increases for their prescription drugs.

Our members, unfortunately, are taking it on the chin from the paying public for such drug price increases. And to add insult to injury, in the end consumers pay twice -- first in taxes to subsidize commercial nonprofits; then again, in increased drug prices due to manufacturer's cost shifting. Even hospital patients pay extraordinarily high prices for prescription drugs; especially when one considers the extraordinary discounts at which the products are purchased.

In our view, no organization, including those that serve to some extent charitable purposes, should be allowed to flaunt current laws by buying and selling drugs and other products at discriminatory prices and reselling excess quantities into the diversion black market. The type of conduct targeted by the legislation does not involve borderline cases.

Typical, for instance, was the case of a 12-bed Florida nonprofit hospital that ordered and received a 42 year supply of an anti-epilepsy drug in a six month period and a 38 year supply of a tranquilizer in an eight month period!! Thus, it is the multitier pricing structure for pharmaceuticals which "provides the principal economic incentive for prescription drug diversion."

Many of the violators are quite bold. In a January 1987 issue of the publication DRUG TOPICS, Director of Pharmacy Services at a nonprofit Rhode Island group health association bragged openly that they were diverting so-called charity drugs into health centers, each of which has a pharmacy, and "because we enjoyed the nonprofit status, we've been able to negotiate price reductions of as much as 90% off wholesale price."

Bogus charities are also involved. For example, the investigation revealed prosecutions brought by the U.S. Department of Justice against corporate officials of a drug wholesale company who fraudulently represented that they were purchasing drugs at charity prices for the Indiana Chapter of AARP. These drugs were diverted into the illegal market and eventually the corporate officials were sent to prison. As if to add insult to injury, the irony of this bogus charity scheme is that AARP hardly qualifies as a charity under the special 1938 exemption to the antitrust price discrimination sanctions.

The ultimate victim of a drug diversion scheme is the consumer. Every American family is affected not only by the high cost of prescription drugs, but by a myriad of public health consequences that are inevitable when such fraudulent procurement schemes take drugs out of the legitimate drug distribution system. Manufacturers are not able to trace the drugs in the event of a recall. Regulatory agencies aren't able to monitor diverted drugs to account for proper storage and handling to preserve drug efficacy.

The former U.S. Attorney in Atlanta, at the October 31, 1985 Oversight Subcommittee hearing "also dispelled the myth that drug diversion can be the consumer's friend by mitigating against the high cost of prescription pharmaceuticals, since the drugs are resold through many levels of the distribution chain, with each intermediary extracting a profit."

The radically low purchase prices are not passed on to the ultimate consumer. In fact few, if any, experience a discount after the chain of criminal diverters has extracted its profits. The losses of the defrauded manufacturers are passed on to NARD members and ultimately to the public through higher prices -- prices that are already artificially higher in order to sustain the current industry practice of price discrimination for select nonprofits.

But such multitier discriminatory pricing practices still are the rule, and so long as they are, they will tempt drug diverters with easy, illegal profits. The Matsunaga/Dingell legislation goes a long way toward solving this problem by establishing serious felony penalties for nonprofit organizations and others who resell drugs to diverters. NARD hopes that this legislation will encourage other manufacturers to adopt a one-price policy, incorporating, of course, legitimate volume and other discounts, for all their customers.

Our primary interest in the legislation is the section which would prohibit resales of pharmaceuticals by hospitals and other health care entities or charitable organizations, including bogus charities. This provision is intended to cover resales by both for profit and nonprofit health care entities. The institutions typically receive discount prices, substantially below the average wholesale price (AWP) for pharmaceuticals, based on their status as a health care entity or charity. When hospitals or other health care entities obtain pharmaceuticals at favorable prices and then resell those drugs at a profit they are unfairly competing with wholesalers and retailers who cannot obtain such a favorable price. Such resales may defraud manufacturers, who are led to believe that the drugs are in accord with current law and for the use of the health care entity, such resales facilitate predatory pricing. In any case, these resales reward the unscrupulous and penalize the otherwise honest and efficient wholesaler or retailer while fueling the diversion market.

In contrast to current limited available sanctions, for example, mail and wire fraud or the RICO statue, the clearly delineated offenses and appropriate sanctions of S.368 will, in our view, provide both the general and specific deterrent necessary to help curb the havoc that such pricing practices have spawned, both in terms of unfair competition and the threat to consumer health and welfare posed by the risk of adulterated and substandard quality diverted drugs.

"These special prices are not available because of volume purchases but are the result of price discrimination tnat is available through a perversion of an era law that forgave price discrimination crimes which benefitted charities.

The scope of discriminatory prices presently available to 6000 (of 7000 total U.S. hospitals) nonprofit hospitals and 228 nonprofit HMOs (of 342 total U.S. HMOs) is highlighted in the following price comparison between the wholesale prices available to our members and the contract prices available to ostensible charities. The accompanying graphic presented to the House Subcommittee on July 10, 1985 by its special investigators, Stephen Sims and David Nelson, portrays a typical drug diversion scam. However, the variety of such conspiracies is limited only by the creativity of criminal minds.

PHARMACEUTICAL DIVERSION

EXHIBIT 1

PRODUCT ANALYSIS BY TIER PRICING

Product	AWP ($)	Contract ($)
Tylenol tabs., 325 mg., 1000	32.34	2.04
Proventil inhaler, each	9.18	2.95
Omnipen-N, inj., 1g., 10s	148.69	35.70
Velosef, 250 mg. caps., 100s	38.71	14.80/10
Lotrimin 1% cream, 15 g. each	5.27	.99
Garamycin, 80 mg./2 ml. inj.	84.50	10.20
Alupent tabs., 10 mg., 100s	12.22	2.99
Depo-medrol, 40 mg. inj.	4.95	2.30
Transderm Nitro, 2.5 mg.	28.70	.30
Nilstat Susp., 60 ml	13.84	1.78
K-Lor, 15 mg., 100	28.58	3.50
K-Tab, 10 mg., 100	10.44	.62
Racn-ce tabs, 100	9.49	3.00

Reference: Statement of Eddie Ronald Burklow before the House Subcommittee on Oversight & Investigations, Committee on Energy & Commerce, September 19, 1985

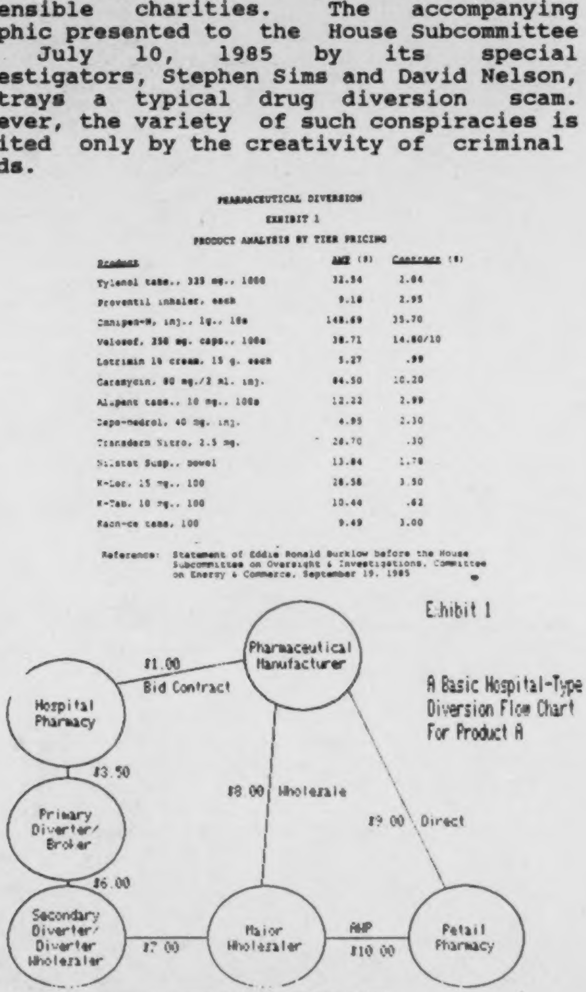
Exhibit 1
A Basic Hospital-Type Diversion Flow Chart For Product A
Pharmaceutical Manufacturer
$1.00
Bid Contract
Hospital Pharmacy
$3.50
Primary Diverter/ Broker
$6.00
Secondary Diverter/ Diverter Wholesaler
$7.00
Major Wholesaler
$8.00 Wholesale
$9.00 Direct
AWP
$10.00
Retail Pharmacy

STATEMENT OF STEPHEN F. SIMS AND DAVID W. NELSON BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS OF THE COMMITTEE ON ENERGY AND COMMERCE, July 10, 1985

Certainly the perimeters of HR 1207 and the felony sanctions provided to make purchases for non-profit health care entities "own use" are relevant to the scope of unrelated business income tax.

GEOGRAPHIC AVAILABILITY

Additionally we are very skeptical about the concept of prescription drugs, medical equipment and devices or other products "not available in the immediate geographic area." Unless a process was established to assure that tax paying businesses such as those we represent determined such availability it would surely prove to be in operation an additional anticompetitive device for nonprofit entities. Lastly, we recommend the adoption of a registration and records keeping scheme similar to that proposed in HR 186 (Chr Luken, D-OH) to help assure compliance and facilitate necessary audits.

ROYALTY INCOME

We see a special need to address circumstances such as AARP nonprofit Pharmacy Services which deducts a two million dollar annual royalty payment to parent nonprofit AARP which pays absolutely no tax on the royalty. In other words we agree with Representative Flippo (D-AL) when he observed during your June 1987 hearings that this situation is a "double - whammy... because even though they get a deduction it is not taxable on their side...."

* * * * * * * * * * * * *

As mentioned at the outset, our members dispense 70% of all prescription drugs in the United States. Recent reports indicate that prescription drugs account for 60% (41.6 to 78.5%) of a typical NARD member's sales volume. Of course, as you are all familiar, the balance of our members' sales volume includes products such as over the counter drugs, health and beauty aids, sundries, greeting cards, gifts and related products.

Additionally, more than 50% of our members are involved with the sale or rental of home health care products ranging from high tech parenteral products to walkers. In all these product categories, we are confronted by commercial nonprofit competitors. It is a top priority with our members.

Again we reiterate our strong support for the subcommittee's proposed reform and on behalf of our members we stand ready to assist the subcommittee in finalizing this landmark reform.

National Automobile Dealers Association
8400 WESTPARK DRIVE · MCLEAN, VIRGINIA 22102

April 14, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The National Automobile Dealers Association appreciates the opportunity to comment on the "discussion options" for amending the rules governing the taxation of exempt organizations currently before the Subcommittee on Oversight of the Committee on Ways and Means.

NADA encourages the Subcommittee to revisit the rules for taxing exempt organizations to identify abuses and propose amendments to existing law where necessary or appropriate to deal with any such abuses. However, NADA is concerned that several of the proposals -- including the aggregation proposal, and the proposals to amend the definition of control, limit the scope of tax-free royalties and alter the treatment of trade show income -- are offered not to remedy actual abuses, but instead to undercut the Congress' long-standing commitment to insulating from taxation an exempt organization's income, other than income from unrelated activities.

Moreover, NADA is concerned that enactment of these options would cause significant hardship to legitimate tax-exempt organizations, disrupting the pursuit by them of their exempt purposes. Finally, NADA doubts whether any combination of these options would produce significant additional Federal revenues. Last year, the Joint Committee on Taxation estimated that a proposal to subject all investment income to the unrelated business income tax would only raise $58 million over a three-year period.

Given the impact of these options on exempt organizations, on the one hand, and the insignificant amount of revenue that would be raised by them, on the other hand, NADA believes that the Subcommitte should refrain from including them in any final package it may put together. Moreover, NADA believes the Subcommittee should only propose legislation which is designed to address and correct specific abuses which have been documented by the Subcommittee. In this regard NADA urges the Subcommittee to consider only measured responses that remedy such abuses and don't cause unnecessary hardship to exempt organizations.

Aggregation

Present law recognizes the time-honored legal principle that the separate status of related entities must be respected unless an entity is a mere shell. In this regard present law permits -- and even encourages -- a tax-exempt organization to establish separate, tax-paying subsidiaries to carry on activities unrelated to its exempt functions. The press release suggests that activities of a tax-exempt organization should be aggregated with those of its controlled subsidiaries for purposes of determining whether the exempt organization continues to qualify for tax-exempt status. NADA opposes this proposal because it cures no actual abuse and could cause an organization to forfeit its exempt status; in such event, tax would be imposed on income that is directly related to the functions for which the organization was granted exemption.

The principal complaint heard during the hearing of the Subcommittee and in 1950 before the full Committee was that exempt organizations should not be permitted to engage in businesses unrelated to their exempt functions without paying taxes on the same basis as their for-profit competitors. This complaint is fully met by the imposition under present law of a tax on the income of for-profit subsidiaries and does not necessitate taxation of the exempt parent as well. Under present law the income of for-profit subsidiaries is fully taxed and no competitive advantage or loss of tax revenue exists. Under these circumstances there can be no justification for placing in jeopardy the exempt status of organizations acting in good faith to accomplish their exempt purposes and paying all of the tax due on income from their unrelated activities.

Discriminatory Tax On For-Profit Subsidiaries

Present law requires that the taxable subsidiary of a tax-exempt parent calculate its taxable income in exactly the same way as do other taxable organizations carrying on similar activities. One option suggested in the press release would require that the tax imposed on a taxable subsidiary never be less than the UBIT which would have been imposed on the tax-exempt parent if the parent carried on the subsidiary's business activity directly. Since the Code restricts an exempt organization's ability to use otherwise deductible expenses to offset UBIT, the effect of this proposal would be to treat income earned by the subsidiary of a tax-exempt organization less favorably than identical income earned by an independent commercial entity. There is no justification for this inequitable treatment of a taxable subsidiary of an exempt organization.

Definition of Control

Under present law investment income received from a controlled subsidiary is taxed as UBIT. For purposes of this rule, 80 percent ownership constitutes control. The press release suggests that the test for determining control should be reduced from 80 percent to 50 percent. NADA opposes implementation of this option because there is no need for it, and because it would tax similar items of income under different rules.

The 80 percent test was added to the Code in 1969 because the Congress recognized that inflated -- above market -- interest, rental and royalty payments by a taxable subsidiary to an exempt parent could enable the subsidiary to reduce its taxable income by making deductible payments that were received tax-free by the exempt parent. The Congress reasoned, however, that if 20 percent or more of the stock of the subsidiary were owned by outsiders, management would be reluctant to enter into arrangements requiring excessive payments. There has been no suggestion that the 80 percent test has failed to accomplish the purpose for which it was enacted. Moreover, if in a rare case the subsidiary violates its fiduciary responsibility by making excessive payments to its parent despite the outside shareholders' ownership interest in the subsidiary, the Service should reallocate income from the exempt parent to the taxable subsidiary and impose penalties on the exempt parent. Legislation requiring additional disclosure that might aid the Service in this regard would appear to be appropriate, as would legislation specifically authorizing the Service to reallocate income from the exempt parent to the taxable subsidiary, and impose penalties on the exempt parent. NADA would support such legislation.

It is important to note that a 50 percent control test would lead to some very strange results. Suppose, for example, that exempt organization A owned 40 percent of the stock of B and 50 percent of the stock of C. Suppose further that A leases space, lends money to, and has continuous extensive dealings with B. Finally, suppose that A has no dealings with C, except that A made one short-term loan to C. Under the option, interest and rent from B would be received tax-free; interest from C would be taxable. So long as the 80 percent control test and other present law rules protect against the excessive payment problem, there is no justification for this distinction. Perhaps it would be wise for the Subcommittee to take a closer look at this kind of distinction and the curious results it would occasion before it finally includes this option in any proposed legislation.

The options also suggest that stock held by all tax-exempt organizations be aggregated in determining whether any one of them controls a subsidiary. No reason is given for this proposal. Since ownership of stock by outside interests is intended to prevent the subsidiary from inflating its payments to its parent by creating a fiduciary obligation to minority shareholders, no distinction between taxable and tax-exempt shareholders seems justified. This proposal has no basis in sound tax policy. It should be rejected.

Royalties

As noted above, under present law royalty income generally is not subject to the UBIT. One of the options under consideration would apply the UBIT to royalties received for the use of property if the recipient created the property or performed substantial services or incurred substantial costs with respect to the development of such property. Apparently, the Subcommittee staff is concerned that income from royalties earned for the use of an exempt organization's name, logo or other intangible assets should be subject to tax. NADA opposes the option because it is unnecessary and because it subjects to tax a type of passive income despite the apparent decision to retain the UBIT passive income exception.

Under present IRS rules, income is considered to have been derived from a tax-exempt royalty only to the extent that (i) the income is derived from the asset (rather than from the performance of services) and (ii) the participation of the exempt owner of the asset is entirely passive. If an association performs any services in connection with the marketing of the products sold using the licensed asset, the Code imposes a tax on all or part of the purported royalty. Thus, under present law and IRS administrative practice, any income treated as an exempt royalty is derived solely from the passive license of an asset. By its very nature such a licensing activity is not competitive with any tax-paying business and is not the type of business that the UBIT was intended to tax. In fact, the kind of licensing activity typical among associations is not a business at all, since it involves no commercial activity on the part of the licensor.

Moreover, almost all royalty arrangements involve a taxable licensee as well as a tax-exempt licensor. Usually, the payment of a royalty results in a higher price for the product sold using the license. Far from creating a competitive disadvantage, the existence of a licensing arrangement should make it easier for taxable competitors of the licensee to compete on the basis of price.

NADA does not believe that there is any reason to adopt this option. No one is harmed by the license of our name. Income derived from such a license should not be treated less favorably than interest income. Neither the license of our name nor the investment of our working capital pose a competitive problem for anyone. There is no harm. There should be no legislation in this regard.

Piecemeal UBIT Exclusions

Among the "piecemeal" exclusions identified in the options paper is section 513(d), which exempts from tax income derived by trade associations and professional associations from the conduct of industry trade shows and conventions. Section 513(d) was enacted in 1976 to reverse IRS revenue rulings issued in 1975 which sought to tax income from trade show exhibit space rentals where selling of products by exhibitors was permitted. In 1986 the provision was extended from section 501(c)(5) and (6) organizations to organizations exempt under section 501(c)(3). In both 1976 and 1986 extensive consideration was given to the issue. It would be illogical to reverse this provision now, and NADA opposes such a reversal.

Nothing could be more closely related to the exempt functions of trade associations than the conduct of membership conventions and trade shows. Such activities permit association members and others to attend educational sessions and to exchange information on industry developments essential to the conduct of their businesses. The trade show portion of a convention provides a convenient means for association members to examine, and obtain information on, products useful to them in their businesses. As Congress previously has determined, the conduct of membership conventions and trade shows is so closely related to the functions for which such organizations are granted exempt status that the income derived from such activity should not be taxed. Moreover, no showing has been made in any of the testimony presented to the Subcommittee that convention or trade show activity results in any competition with for-profit businesses or any other abuse.

* * *

These particular proposals are not loophole closers or revenue raisers; rather they reflect an interest in undercutting the Congress' long-standing commitment to insulating from taxation an exempt organization's income, other than income from unrelated activities. We urge you to recognize this and to consider whether measured loophole closers would be more appropriate under the circumstances.

Thank you for your consideration of these matters.

Sincerely,

H. Thomas Greene

H. Thomas Greene
Executive Director
for Legislation

STATEMENT OF NATIONAL CLUB ASSOCIATION CONCERNING UNRELATED BUSINESS INCOME OF SOCIAL CLUBS

APRIL 15, 1988

NATIONAL CLUB ASSOCIATION
1625 I STREET, N.W.
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I. Introduction

The National Club Association (NCA) of Washington, D.C. has over 1000 members, of which about 800 are tax-exempt social clubs, and the remainder are nonprofit or proprietary taxable clubs. We are writing to comment on the proposal in Oversight Subcommittee Press Release No. 16, which would --

> Codify IRS position (upheld by some courts) that a social club (or other organization whose investment income is subject to UBIT) may not, in determining UBIT, reduce its net investment income by losses on sales to non-members.

NCA is opposed to enactment of a provision of this type because it is unnecessary and premature. The issue typically involves small amounts of taxes. The courts are now applying traditional profit-motive factors, and Congress should not intervene in that process.

II. Administrative and Judicial Background of Issue

Revenue Ruling 81-69, 1981-1 C.B. 351, addressed a situation where a tax exempt social club "sells food and beverages to nonmembers at prices insufficient to recover the costs of such sales," and "the club's sales of food and beverages to nonmembers have consistently over a number of years resulted only in losses and there is every indication that such sales to nonmembers will continue to result in losses." The ruling holds that, "because [such] sales to nonmembers are not profit motivated, the social club may not * * * deduct from its net investment income its losses from such sales to nonmembers."

Whether losses from taxable nonmember food-beverage sales may offset taxable investment income has been discussed in several court decisions. In Cleveland Athletic Club v. United States, 779 F.2d 1160 (1985), the Sixth Circuit held that Revenue Ruling 81-69 was invalid, on the ground that Code Section 512(a)(3) does not require a club to have a profit motive to deduct unrelated business expenses. The Court concluded that Rev. Rul. 81-69 conflicted with the explicit language of Section 512(a)(3), reasoning that Section 512(a)(3) requires that all kinds of unrelated (nonmember) income and deductions be grouped together into one computation, aggregating all nonmember-source income and deductions--e.g., from food and beverages, investments, and other unrelated activities. It recognized that Section 512(a)(3) is quite different from Section 512(a)(1), which allows deductions only for "trades or businesses" and which requires a profit motive. The Court further held that although a social club need not have a profit motive for its nonmember food-beverage activity, it must--like all nonprofit organizations--have a purpose to earn an economic gain in order to deduct food-beverage tax losses, relying on the Court of Claims' decision in Trustees of Graceland Cemetery Improvement Fund v. United States, 515 F.2d 763 (Ct. Cl. 1975).

In The Brook, Inc. v. United States, 799 F.2d 833 (1986), the Second Circuit considered a situation where the taxpayer had stipulated that it had no profit motive on its nonmember food-beverage business, and introduced little if any evidence of its intent to earn an economic gain. The Circuit Court held that a profit motive was necessary for the club to offset its nonmember food-beverage losses against investment income.

More recently, in North Ridge Country Club v. Commissioner, 89 T.C. No. 40 (copy attached), a unanimous reviewed opinion of the Tax Court considered a situation where a club's sales to nonmembers exceeded its direct costs of such sales, but the club had tax losses on such activity after deducting allocated indirect expenses. The Court held that it need not address the rationales of the Cleveland Athletic and Brook cases, or determine whether Revenue Ruling 81-69 was correct in requiring a profit motive. Instead, analyzing all the facts of the case on the basis of factors similar to those used in tax shelter and hobby loss cases, the Court held that the club had a profit motive for its nonmember business and could thus deduct all the stipulated directly connected expenses.

In Portland Golf Club v. Commissioner, decided February 24, 1988, the Tax Court applied the North Ridge test, and held that an analysis of all the facts and circumstances demonstrated that the club had a profit motive for its nonmember food-beverage business. The Internal Revenue Service, as of this date, has not yet decided whether to appeal North Ridge or Portland Golf.

III. Congress Should Not Overrule the Tax Court and Impose a Draconian Deduction Prohibition

A. The challenged losses are in the ordinary course of business, and are not tax avoidance devices.

It is apparent that a provision codifying Revenue Ruling 81-69 would not resolve the vast majority of cases involving deduction of nonmember food-beverage expenses. Under the Tax Court's decisions, clubs would properly still be entitled to demonstrate that they had a profit motive despite the existence of losses for tax computation purposes.

What the Treasury proposal suggests would go far beyond Revenue Ruling 81-69. It would require a provision absolutely prohibiting a club from deducting expenses in excess of gross income when they arise from nonmember food-beverage business, regardless whether a club has a profit motive under accepted tax shelter and hobby loss standards. Such a rule is unprecedented in the federal tax code. It would penalize social clubs in circumstances where they are earning as much profit as they are able -- charging the highest prices they can and operating at maximum efficiency -- with absolutely no intent to operate any sort of tax shelter or tax sham. For example, in the Portland Golf Club case, the Club actually showed a profit under one I.R.S. approved expense allocation method, but showed a tax loss only because it had selected another I.R.S. approved allocation formula. The Code should not put stricter rules on bona fide club operations than it imposes on tax hobbyists or tax shelters.

A prohibition on offsetting a club's business losses against business profits would constitute a form of taxation of gross income, which the Code has never done. All nonmember activities of social clubs are subject to tax if they are profitable. Taxable businesses frequently offset losses on one taxable activity against profits on other taxable activities -- for example, movie theaters have losses on admissions but make profits on the concession stand, but report income and expenses on an aggregated basis. Clubs should not be precluded from similarly aggregating their income and expenses on profit seeking, taxable activities.[1]

B. Nonmember business of tax-exempt clubs is not unfair competition

The thrust of proposed UBIT legislation is to reduce unfair competition. NCA represents many taxable proprietary clubs, and is not aware of any complaints from the for-profit community that tax-exempt clubs engage in unfair competition. The proposed legislation would actually place the nonmember business of tax-exempt clubs at a competitive tax disadvantage.

IV. The Legislative Branch Should Not Intervene in Ongoing Judicial Resolution of the Issue

We submit that it would be inappropriate and premature for the Congress to legislate on this issue at the time, in the midst of litigation which is likely to resolve the issue in a fair and even handed way. We understand that the Ways and Means Committee is sensitive to the separation of powers and comity between the Legislative and Judicial Branches, and ordinarily does not seek to intervene in pending litigation to impose a legislaive fiat. That position is good tax policy in the abstract, and is particularly apropos here, where the Tax Court has recently set forth a new compromise rationale which is likely to result in allowance of some deductions and disallowance of others. Under the Tax Court's standard, clubs will either have to increase their efforts to demonstrate an economic profit motive, or they will lose tax loss deductions. The likely appeals in North Ridge and Portland Golf, and a pending Claims Court case,[2] will probably further refine the profit motive test. Moreover, as a practical matter, many of these profit motive cases are resolved through compromise, with the Service allowing part of the losses, or a loss on one activity, and disallowing other losses.

V. Congress Should Not Legislate on Fragmented Social Club Issues, But Should Instruct Treasury to Promulgate Comprehensive Regulations

It is particularly inappropriate for Congress to intervene at this time on this single social club issue, given the Internal Revenue Service's 20-year old unwillingness to publish Regulations on the wide range of unrelated business tax issues facing social clubs. In 1971, only two years ater enactment of the new statute applying the unrelated business tax to social clubs, the Service issued comprehensive Proposed Regulations. Both the club industry and the Service abided by these Regulations for 17 years, until they were suddenly withdrawn in their entirety, without any explanation, in January of 1987. The Tax Court and the Sixth Circuit have noted that a key provision in these Regulations, issued only a short time after enactment of the statute, was contrary to Rev. Rul. 81-69.

It is bad tax policy for Congress to adopt, prematurely, a fragmented approach on isolated tax issues which are clearly not abusive. Instead, the Treasury Department should be instructed to adopt comprehensive regulations on the whole range of unrelated business issues affecting social clubs. This is not a major task; indeed, the National Club Association would be quite pleased to see adoption of the comprehensive Proposed Regulations which struck a proper balance over the whole range of UBIT issues affecting social clubs.

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[1] We do not quarrel with Section 512(a)(3)'s prohibition on offsetting exempt function losses against taxable (nonmember) income, but that is an entirely different question.

[2] Petroleum Club of Houston v. United States, Cl. Ct. No. 153-86-T, in which cross-motions for summary judgment have been filed and a decision of the Court is awaited.

Promoting special legislation dealing with tax losses of social clubs would necessarily be quite complex and certainly controversial. Why should the Code be required to detail numerous rules for determining whether and when a club has a tax profit, when the courts have already developed and are applying a flexible body of accepted factors. New legislative standards would likely lead to a new round of litigation as to the meaning and application of the statutory tests. As noted above, codification of Revenue Ruling 81-69 would not solve the problem, since the courts have already held that the Ruling raises more profit motive issues than it solves.

In many cases, whether a nonmember activity operates at a tax profit or a tax loss has little to do with economic reality, but depends on how depreciation, interest, property taxes, salaries, and wages are allocated among various activities, such as the restaurant, bar, party rooms, golf course, pro shop, and the like. Attempting to craft fair legislative rules which would take into account all the variables would be much more difficult than the complex rules in I.R.C. Section 183. At this stage, it would be better tax policy to allow the courts to attempt to fashion workable tests and have the Internal Revenue Service abide with them.

VI. No Change Is Necessary in the Deductions Allocation Formula Used by Social Clubs

One other issue in the Press Release could affect social clubs, and could be related to the issue involving food-beverage expense deductions arising from nonmember business. Part VIII of the Press Release, entitled "Allocation Rules", proposes to overrule Rensselaer Polytechnic Institute v. Commissioner, 732 F.2d 1058 (2d Cir. 1984), by disallowing all or part of the "general overhead" or "depreciation" allocable to the unrelated business under the time-of-use formula in Rensselaer. That case requires overhead and depreciation expenses to be allocated on the basis of actual time of use, with time of nonuse disregarded.

This allocation formula has very little application to tax-exempt social clubs. Since the mid-1970's, I.R.S. and social clubs have applied a gross-to-gross method of allocating expenses between member and nonmember income. Under that method, fixed expenses are allocated according to the ratio of gross income from member business and gross income from nonmember business. No time factors are involved. In all of the Rev. Rul. 81-69 cases, this gross to gross method was stipulated to be correct. Virtually all clubs use this method.

Accordingly, we see no reason for legislative tinkering with this allocation formula, which has worked well for over a decade. It has the virtues of simplicity of application, ease of audit, and universal acceptance.

VII. Conclusion

In conclusion, the National Club Association strongly opposes any proposal which would attempt to deal with the issue of offsetting losses on one taxable nonmember activity against profits on other nonmember activities. The courts are in the process of fashioning workable rules, and many of the cases are resolved through settlement. Any attempt at a legislative solution, which would have to take into account the anomalies of tax loss computations, would be too complex an approach to a resolvable concern.

A copy of the Tax Court's unanimous reviewed opinion in North Ridge is attached for your convenience.

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April 15, 1988

Robert J. Leonard, Esquire
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

On behalf of the National Cosmetology Association, Inc. ("NCA"), we submit these comments on the preliminary discussion options regarding the unrelated business income tax ("UBIT") issued by the Subcommittee on Oversight of the House Committee on Ways and Means. NCA is an association representing almost 50,000 cosmetology professionals located throughout the United States.

At the outset, NCA wishes to compliment the Subcommittee on its comprehensive investigation of these complex issues. Clearly, the United States cannot afford to overlook any revenue-raising measures which might make a positive contribution to the current budget deficit. Nor can it afford to overlook abuses of the tax-exemption laws. However, NCA is seriously concerned that some of the measures identified by the Subcommittee will not merely address problems in this area but will unnecessarily and unfairly inhibit 501(c) organizations from pursuing legitimate, exempt functions. We therefore urge the Subcommittee to carefully evaluate its discussion options in light of these concerns. Any overly broad legislation would certainly cripple the ability of tax-exempt organizations, such as NCA, to pursue activities which benefit the public interest — activities which Congress has traditionally supported.

More specifically, NCA respectfully requests the Subcommittee to eliminate certain discussion options from further consideration. They are proposals concerning royalties; trade show income; and the relationship between exempt organizations and their for-profit subsidiaries.

(1) Royalties

Although current law does not tax royalty income under the unrelated business income tax provision, the Subcommittee proposes the application of UBIT "to royalties measured by net or taxable income derived from the property; or royalties received by an organization for use of property if such organization, or closely related organization, either: (1) created such property, or (2) performed substantial services or incurred substantial costs with respect to the development or marketing of such property." NCA believes that any revision of existing law in accordance with the Subcommittee's discussion option is both unnecessary and inappropriate.

In NCA's view, the current regulations governing royalties are adequate to prevent any abuse of this privileged tax status. Currently, such income is only exempt from taxation if it is derived from the asset and if the exempt organization does not perform any services to obtain the income. Subject to such constraints, tax-exempt organizations have been free to earn nontaxable income from royalties paid to use the exempt organization's name or logo. Given that this type of licensing activity cannot be deemed to give tax-exempt organizations an unfair advantage over for-profit entities, it is improper to subject this passive income to taxation. Further, since the taxable licensees probably had to increase its prices in order to compensate for the royalties paid to the tax-exempt organization, it is likely that such licensees are at a price disadvantage vis-a-vis their direct competitors. For these reasons, NCA firmly believes that royalty income should not be subject to the unrelated business income tax.

(2) Trade Shows

According to the press release requesting public comment, the Subcommittee is considering modification of various piecemeal UBIT exclusions enacted since 1969. One such "piecemeal exclusion" identified in the option papers is the provision which codifies the tax-exempt status of income received from trade shows and conventions. NCA strongly objects to a revisitation of this issue which Congress has considered at length twice in recent years. Indeed, the original legislation on this issue was specifically targeted at overturning IRS revenue rulings which sought to tax such income. Given the recent congressional attention to this issue and the lack of evidence at recent hearings that such activity is subject to abuse, it seems entirely inappropriate for Congress to reconsider this provision.

Moreover, there is no substantive reason to do so. There can be no question that trade show activity furthers the tax-exempt purposes of nonprofit organizations. Not only do trade associations use such events to hold association meetings and to conduct educational seminars but the trade shows themselves provide an opportunity for members of an industry to learn about new developments, products and services. Clearly, such activities further the exempt functions of such organizations.

(3) Taxable Subsidiaries

The discussion options have various provisions which would affect the relationship between tax-exempt organizations and their taxable subsidiaries. First, it is suggested that "a controlled taxable subsidiary's income can be no less than its UBIT would have been if the income-producing activity had been carried on directly by the exempt parent organization." If this proposal is codified, such income would be subjected to greater taxation than the income earned by an identical for-profit corporation which did not happen to be affiliated with a 501(c) organization. Such increased tax liability would be incurred because exempt organizations are unable to use deductible expenses in the same manner as for-profit corporations. In general, exempt-function expenses cannot be used to offset UBIT. Because of the unfairness of such a policy, NCA urges the Subcommittee to abandon this proposal.

Second, the Subcommittee is considering aggregating the income and activities of controlled subsidiaries with their parent organizations to determine if the parent primarily serves tax-exempt functions. The press release implies that, if an adverse determination is given, the parent's tax-exempt status would be in jeopardy. NCA sees no reason for "piercing the corporate veil" on a per se basis merely because one entity is tax-exempt and the other is not. Any such wholesale disregard of the separate legal existence of corporate entities would only result in the taxation of activities which have traditionally been considered in furtherance of exempt purposes. Moreover, since unrelated business activities are already subject to UBIT, it is entirely inappropriate to obliterate the distinction between tax-exempt parents and their taxable subsidiaries. NCA therefore opposes this recommendation which does not address a particular abuse and which would threaten the tax-exempt status of organizations legitimately serving exempt purposes.

* * *

In conclusion, the National Cosmetology Association urges the Subcommittee on Oversight to carefully evaluate its proposals and to ensure that they do not unfairly circumscribe the activities of tax-exempt organizations to such an extent that these worthwhile organizations find it difficult to survive. Thank you for your consideration of these comments.

Very truly yours,

Lauren R. Howard

LAUREN R. HOWARD

Counsel to the National Cosmetology
Association, Inc.

Statement submitted by
National Easter Seal Society
to the
House Subcommittee on Oversight

April 15, 1988

This statement is submitted on behalf of the National Easter Seal Society in response to the discussion options contained in Press Release no. 16, dated March 31, 1988 ("Release"), concerning potential revisions of the federal law pertaining to taxation of unrelated business income of tax-exempt organizations. We appreciate the opportunity to express our views on the proposals in the Release and hope that the information we provide to the Subcommittee on Oversight will be helpful in resolution of the issues.

Introduction

Our organization does not compile data relative to the applicability of the unrelated business income tax (UBIT) to the activities of our affiliates. However, based on the information that we do have, it appears that the current regulatory scheme is workable. It seems adequate for the task of resolving any difficulties that may exist between for-profit businesses and tax-exempt organizations.

The National Easter Seal Society is one of the country's best-known and most effective charitable organizations. We were founded in 1919 and, today, we are the leader among voluntary organizations providing direct services to persons with disabilities. The National Health Council recently cited the National Easter Seal Society as the member agency with the highest percentage of program expenditures devoted directly to patient services. 93% of our program expenses, or approximately $149 million, are utilized for patient services.

The Easter Seal Society is a nationwide network of separately incorporated affiliates that is united in the common mission of promoting the maximum independence of persons with disabilities. Approximately 200 state and local Societies operate more than 400 program service sites across the country.

The National Society, headquartered in Chicago, is a separate corporation that provides assistance to the network of affiliates. Generally, there are no mandates from the national headquarters relative to the programs of local Societies. Services provided by local Societies are tailored to meet specific community needs. This policy gives local affiliates a great deal of flexibility in developing programs and enables them to be responsive to a changing environment.

As community needs are identified, Easter Seals is there to assist persons with disabilities and their families in making effective use of resources that will help them develop their abilities and live purposeful lives. Although no specific services are mandated, Easter Seal programs must meet nationally-recognized, independent accreditation requirements and performance standards to assure quality care and efficient operations.

Our organization often provides services financed with contributed dollars which would not otherwise be available to persons in need. Our flexibility and resourcefulness enable us to address problems that the government, for one reason or another, is unable to solve.

Services provided by local Societies often vary from one area to the next. Services provided by our affiliates include: physical, occupational and speech-language therapies, vocational evaluation and training, camping and recreation, psychological counseling, attendant care and transportation. Prevention of, and screening for, potential disabling conditions are also encouraged and sponsored by Easter Seals.

Individuals of all ages with disabilities resulting from any cause can find assistance through our programs. We provide services to a broad cross-section of people including the two-year-old child with cerebral palsy, the thirty-year-old worker with a brain injury, and the senior citizen who has had a stroke.

The contribution of volunteers in our organization is extremely important. An estimated 800,000 volunteers give their time, talent and resources to the people served by our agency.

Detailed information about the programs and revenue sources of the Easter Seal Society was submitted to your Subcommittee during the hearings that you held on UBIT in June, 1987.

"Substantially Related" Test

Of course, present law utilizes a "substantially related" test in ascertaining the presence of a taxable unrelated trade or business. We urge the retention of this test. Generally, the test has worked well and we see no need to abandon years' worth of precedential law that has accumulated on the point.

Thus, we believe that any problems concerning taxable income-producing activities of tax-exempt organizations are much more properly addressed through the use of specific provisions, rather than by means of radical changes in the overarching principles.

Therefore, we oppose resorting to a "directly related" test and oppose an approach calling for a determination of whether each income-producing activity standing alone is tax-exempt. The former would not add any clarity to the law and the latter would be incorrect because it would fail to take into account the context in which an activity was being conducted.

We also oppose the use of any general standard whereby an "inherently commercial" test would be used to determine whether an activity is "unrelated." This is a very dangerous concept, with immense adverse repercussions for the entire independent sector. It should not be implemented.

Routine Testing Income

One proposed option would "apply UBIT to routine testing income (with exceptions for Federal and State mandated activity, pre-surgical medical testing, and laboratory testing which is part of a student educational training program)." The explanation for this proposed change is that routine testing is an activity "whose nature and scope [is] inherently commercial, rather than charitable."

Application of UBIT to routine testing income would appear to affect the National Easter Seal Society's screening services which test for physical, cognitive and emotional disabilities.

Many of our state and local affiliates currently provide screening and evaluation services which assess individuals for learning, hearing, visual, orthopedic, or other disabling conditions. During the year 1986/1987, the Easter Seal Society screened over 268,000 individuals for postural difficulties, nearly 36,000 individuals for speech and language disabilities, over 99,000 individuals for hearing disability, and over 66,000 people for vision problems.

The Society's screening programs are not inherently commercial. It should not be the intent of Congress to tax testing for disabilities carried out by the Easter Seal Society. Accordingly, the proposed option to apply UBIT to routine testing income should not be enacted, or if enacted, should be modified to exclude programs such as the Society's health screening program.

Sales and Rentals of Medical Equipment

The discussion options include a proposal to tax all sales or rental income of medical equipment and devices, with certain exceptions. Since many of our affiliates provide prosthetic and orthotic devices and other medical equipment to persons with disabilities, this proposal would affect our programs.

The medical equipment which some of our affiliates provide includes wheelchairs, canes, walkers, hydraulic transfer devices, prosthetic devices such as hearing aids and artificial limbs, and orthotic devices such as back braces and shoes with braces. In some cases, we purchase the equipment from a supplier for patients who do not have the money to pay. In other cases, we provide the equipment directly to the individual as part of the overall treatment program.

A very large percentage of the individuals that we serve are people with very limited financial resources. Many are below the poverty line. When these individuals need medical equipment in order to function more independently, our affiliates provide the equipment at no cost to the patient. Charitable contributions are used to meet the needs of those unable to pay.

Although a predominant number of the recipients of our services are low-income individuals, we do serve some people who have adequate resources. When medical equipment is sold or rented to these individuals, they are charged on a sliding scale. Needles to say, it would make no sense to use charitable donations to subsidize services to those who have the ability to pay.

A few of our affiliates provide hearing aids to those with hearing loss. Again, only those with adequate resources are required to pay for these devices. Furthermore, when an Easter Seal affiliate is involved in the sale of a hearing aid, that service is part of a comprehensive aural rehabilitation program, which includes a full range of speech, hearing and audiological services.

The provision of medical equipment by an Easter Seal affiliate is typically part of a comprehensive rehabilitation program. For example, when artificial limbs are provided to an individual, the patient typically is working with a physical therapist and occupational therapist to overcome the disability. Our mission is rehabilitation and the provision of medical equipment is one component of the overall rehabilitation treatment plan.

With respect to Easter Seal programs, we believe that this proposal would create an unnecessary burden which would impede our ability to provide services to persons with disabilities. We urge withdrawal of the recommendation relative to the provision of medical equipment.

Affinity Card Arrangements

The discussion option proposes the taxation of revenue derived from affinity credit card arrangements involving tax-exempt organizations.

During recent years charitable giving to Easter Seals by individual donors has leveled off. Therefore, we have looked for innovative ways of maintaining our funding base. One of the most recent additions to our fundraising program is an Easter Seal affinity card. It promises to provide a significant amount of revenue for services for persons with disabilities.

We are struggling to develop sources of revenue in the face of declining support from traditional sources. It seems that each time a revenue-producing program is developed, there is a proposal to tax it. Taxation of the affinity card revenue will merely discourage this revenue production technique; it will not raise any revenue for the government.

We submit that there has to be some balance between theoretical tax policy and the revenue-raising activities of nonprofit organizations. Thus, we urge that the revenue derived from affinity card programs continue to be treated as tax-exempt.

Commercial Co-Venturing

Another manifestation of the fund-raising partnership between Easter Seals and corporations is our various commercial co-venturing programs. (The term "commercial co-venturing" is an unfortunate one, since it inappropriately connotes "commercial" activity by the charitable organization, but that is the phraseology used in the state charitable solicitation acts.) These are arrangements where a corporation agrees to provide support to Easter Seals or one of the affiliates based upon the volume of sales of a particular product of the corporation to the general public during a particular period of time.

In our view, this type of support clearly is gift support and thus is nontaxable to Easter Seal affiliates. We do not see anything in the Release that would adversely affect the present tax law concerning commercial co-venturing and trust that the reference in item I, I. of the Release is not intended to affect commercial co-venturing programs. We certainly urge this result.

"Piecemeal Exclusions of Certain Activities"

Item X of the Release states that the Subcommittee may be considering modification of the "various piecemeal UBIT exclusions enacted since 1969."

While we cannot ascertain at this point precisely what such a reconsideration might entail, we would request that the rules concerning the tax treatment of rentals and exchanges of mailing lists, contained in IRC § 513(h), not be changed. These rules are important to Easter Seals, represent a fair tax policy position on the matter, and warrant retention.

Furthermore, we strongly oppose the taxation of income from fundraising activities in which low-cost items are given to contributors. This would impede the continuation of many traditional fundraising events which are widely accepted by the general public as being within the purview of legitimate charitable activity.

Special Event Fund-Raising

Like many charitable organizations, Easter Seals and its affiliates use special events as fund-raising occasions. These events include auctions, sports events, and raffles. These are infrequently carried on but may become taxable if the "regularly carried on" test is repealed.

We suspect that this outcome is not intended by the options. Therefore, we request that this test not be repealed. If, however, for other reasons, the test is repealed, we request that the tax law definition of the term "trade or business" in this context be revised to make it clear that special event charitable fund-raising is not a "business" for tax purposes.

Gift Shop Income

A few of our affiliates have homebound programs for individuals with disabilities. These people work out of their homes producing arts and crafts items which are sold through an Easter Seal outlet. The Society accepts the items on a consignment basis. The client who produces the item gets most of the proceeds of the sale with the Society retaining a small amount for overhead. These homebound gift programs are typically run by volunteers. The application of UBIT to this type of activity would discourage programs which offer homebound individuals the opportunity to become more independent and productive. Therefore, we urge you to maintain current law in this regard.

Conclusion

We are concerned not only about many of the specific items in the Release, but also about the tone and general direction of the document. After reviewing the proposals, we have concluded that the passage of these provisions would severely restrict the activities of thousands of nonprofit organizations, including Easter Seal affiliates across the country. It would be a major step toward diminishing the role of charitable organizations in our society.

The impact of these proposals on Easter Seal programs would be substantial. Simply put, it would transfer Easter Seal funds currently being spent on patient services such as wheelchairs, walkers, braces for children with disabilities, physical therapy and speech-language therapies to the federal treasury.

The underlying premise implicit in these proposals is that a charity should be taxed on income from services or activities that are "inherently commercial," or, in other words, regularly carried on by corporations or other businesses. Many of the services provided by Easter Seal Societies are also provided by businesses. Our programs include health screening, transportation, recreation, day care, vocational evaluation, training and placement and medical rehabilitation services such as physical, speech-language and occupational therapies. Therefore, if the Subcommittee moves in the direction of imposing a "commerciality" or "competition" test on the activities of charitable organizations, it will jeopardize programs serving persons with disabilities and others who have special needs. It is difficult, if not impossible, to determine where the line will be drawn if a "competition" test is imposed. Given such a subjective standard, the IRS is likely to impede many of the legitimate activities of nonprofit organizations by imposing the corporate income tax.

There is a need for improved reporting to the IRS to increase enforcement and compliance with the relatedness test under current law. Last year, Independent Sector submitted comments on the Treasury Department's testimony before the Subcommittee which includes several recommendations for improving the statutory, regulatory and administrative framework for enforcing UBIT. We endorse those proposals as an adequate starting point for revisions to UBIT.

Statement
# of the
National Electrical Contractors Association, Inc.
on the subject of
Taxation of Unrelated Income
of
Trade and Professional Associations
to
The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
# of the
House Ways and Means Committee
and
Members of the Subcommittee

The National Electrical Contractors Association (NECA) is a trade association representing the interests of this nation's electrical construction contractors. These businessmen - most of whom classify as small business -provide materials and labor for installation, modernization and repair of electrical systems and subsystems. There are more than 45,000 electrical contractors in this country, employing more than 400,000 electrical workers. They do power line construction; they work on residential, commercial and industrial facilities and well as on educational, institutional and transportation-related jobs. The annual volume of electrical construction is over $15 billion.

NECA is extremely concerned with the direction the House Ways and Means Oversight Subcommittee is taking in its review and consideration of the taxation of so-called "unrelated business income" of otherwise tax-exempt organizations. While not unmindful of some of the more egregious examples of tax exempt activity, we feel that the Subcommittee should tread very carefully and narrowly so that the legislative application of any of its decisions does not do vastly more harm than good.

The Treasury Department and the Internal Revenue Service are not notoriously conservative when making decisions as to the coverage and intent of a piece of tax law. They tend to work with a broad brush when it comes to deciding who must pay and a fine-lined stylus when deciding who is not covered.

Our organization is a full-service trade association, providing a broad spectrum of services to our industry and our membership. We have a national staff with expertise in management, marketing, codes and standards, safety, job cost estimating, industry research, communications, government affairs and labor relations. In addition, we maintain a large field staff to help bring these services to the contractor. Everything we do, whether for a fee or at no charge, relates to our mission.

To change the "substantially related" test to a "directly related" test would allow the IRS the leeway to challenge everything an organization does. Essentially it would require some kind of discrete, objective vertical test to determine if each separate publication or service meets the criteria for "directly related" and if there is any taxable income stemming from it. Now associations do not work that way. Each product or service is not considered in the same way a profit-making firm would handle a similar item. A profit-making firm would set prices based on cost plus overhead and profit on a per-unit basis.

In our case, however, different judgement criteria must be applied - that is: how important is the product (publication) or service to the industry? If it is extremely important, it may be made widely available at no charge. If it is of less importance or affects only a portion of the industry, then a fee may be charged to recoup production costs. Since dues and service charges generally underwrite costs of development and delivery of services, income helps offset general production expense. To apply a "stand alone" test to each activity would mean the end of tax exempt trade associations.

In setting fees for those products and services for which they are charged, we maintain a price differential for members and non-members. The higher price for non-members helps pay a share of the development costs originally underwritten by dues-paying members. What might appear to be a profit if viewed on a vertical, product-by-product basis, is no profit at all when viewed in light of the entire range of association activities.

There are no profits in a trade association. Funds are utilized and services expanded or contracted according to their availability. For our association to open, say, a car wash would be ludicrous and clearly outside the scope of our mission and should be taxed. But where something falls within the realm of the mission of the association, it should remain non-taxable. Because of the determination of the IRS to construe everything as narrowly as possible, it is important to the financial stability of an association that the "substantially related" test not be altered.

NECA and other similar organizations provide substantial service to the industries they represent and to the general public. We help develop and maintain industry safety standards. We actively discourage activities could lead to being construed having antitrust implications. We provide training in good management practices so that the contractor can be more efficient and, ultimately, more productive and so the customer can be assured of quality and competence in his electrical construction work. We work with other organizations in the industry to negotiate procedures which allow construction jobs to proceed with maximum cooperation and a minimum of disharmony. We do research on both technical and administrative aspects of the industry. We develop marketing analyses which assure that electrical contractors not only know the industry as it exists today, but have an idea of what it is going to look like tomorrow.

We develop and provide books, pamphlets, brochures, slide shows, video tapes and other media to deliver this information to the industry. We provide on-site instructional programs for contractors so they may broaden and build their technical and managerial skills. We develop and publish industry statistics. And as part of our services we publish a weekly newsletter to our membership and a monthly magazine to the industry - at no charge. We also run seven district meetings and a national convention annually.

To pay for this broad array of services for our industry requires substantial financing. Because of current law, our magazine is a separate business entity and, as such, is taxed as a profit-making business (when it makes a profit). However, any income earned by the magazine is not really "profit". It is money that is turned right back to the industry through increased or enhanced services. We have always felt that this income, earned from advertising revenue in a magazine which publishes informational material directly related to the electrical construction industry and which is provided to the entire industry at no charge, is substantially related to the tax exempt mission of the organization. The legislative and executive "broad brush", however, has swept that away, and money that could and should go to better the industry now goes for taxes.

Development costs of the reports, training guides, and other published materials we provide to the industry are financed from the dues and service charges paid by our members. Some of these materials are provided at no charge; some are provided for a fee which helps underwrite production costs. All are listed in a *Index of Services* we provide annually to our members and others in the industry. To implement a UBIT on these "off-premises" or "catalog" sales, as presented in your "discussion options A", would be, essentially, a reversal of the original intent of Congress in allowing tax exemptions for 501(c)(6) organizations in the first place!

If distribution of this Index and any sales resultant to it were to be subject to UBIT, it would frustrate and financially truncate the very reason this organization and others like it exist. It would curtail our ability to provide services to this industry which benefit the industry and the general public.

SUMMARY

The direction in which the Subcommittee seems headed is toward rigidity, detail, and specificity. Where the product or service of the association relates to its mission, even obliquely (other than as simply a money-raising venture), UBIT should not be applicable. An association should not be allowed to run a car wash (unless, perhaps, it is for research by the car wash association). But income from the sale of manuals, books, pamphlets, or related services (such as workshop training fees, etc.) should not be subject to taxation so long as the organization is using the funds obtained to further its mission.

Rigid and tightly applied new standards for taxation could destroy the ability of an association to provide services to its industry. Flexibility, applied with reason, is needed. If lines are drawn too tightly, it is virtually certain that resultant regulations and enforcement will cripple an association infrastructure which provides business and the entire American public with tremendous benefits.

In your deliberations on UBIT and associations, NECA urges that you keep an eye focused on the forest of intent and not on the specifics of individual "trees" - to do otherwise will kill the forest of benefits associations provide, tree by tree.

We urge that you retain the "substantially related" test, that you do not go to a "stand alone" determination of the tax exemption of each discrete activity, and that you not apply UBIT to income from off-premises or catalog sales. Thank you for allowing us this opportunity to present our views.

NFIB

National Federation of
Independent Business

COMMENTS OF
JOHN J. MOTLEY, III

Director, Federal Governmental Relations

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Submitted To: House Ways and Means Committee, Subcommittee on Oversight

Subject: Submitted Comments on Discussion Options on the Unrelated Business Income Tax

Date: April 15, 1988

On behalf of the more than 500,000 business owners who are members of the National Federation of Independent Business (NFIB), I submit the following comments on the discussion options relating to the Unrelated Business Income Tax (UBIT).

Last June this subcommittee began an examination of the tax code sections and the Unrelated Business Income Tax rules. It was a courageous act. Asking whether the UBIT statute fairly taxes non-profit organizations was instantly portrayed by the non-profit community as an attack upon it and those who benefit from its charitable activities.

However, after five days of hearings, even the more skeptical members of the subcommittee became convinced that there is a vagueness in UBIT rules which allows well-meaning non-profit organizations to compete unfairly with small business owners.

NFIB wishes to congratulate the members of the subcommittee and its staff for the prompt manner in which this issue has been addressed. The draft recommendations are a recognition that some form of a commerciality standard is necessary.

We fully realize that modifications to the discussion draft may be necessary as the subcommittee's deliberations continue and we stand ready to work with you on areas that may need revision. One modification needed is a test of commerciality based on a standard which is clearer than the substantially related standard in current law. Otherwise, the problems exposed in the hearings will simply return in the future.

Specific Comments:

The "Substantially Related" Test

The draft discussion document offers three options for dealing with the current test for a substantially related activity. They are:

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1. repeal the "substantially related " test and replace it with a "directly related test";
2. determine whether each income-producing activity standing alone is tax exempt;
3. retain the "substantially related" test, but impose UBIT on specified activities whose nature and scope are inherently commercial.

The current "substantially related" test and its broad judicial interpretations are in large measure responsible for much of the uncertainty which exists in the non-profit statutes and has resulted in the large number of commercial activities of non-profits. Imposition of a modified substantially related test, a directly related test, or a straight, stand alone income-producing standard each has a distinct advantage in solving the problem.

Whatever standard is eventually adopted for determining whether a non-profit subsidiary should be taxed as a commercial venture, the standard should:

1. contain a clear test to determine when a commercial activity is taxable under the UBIT statute;
2. be sufficiently flexible to take into account transactions and situations which will certainly evolve in the future.

Many of the problems raised by the NFIB membership could be effectively dealt with by the recommendations in sections A-L of section 1 of the discussion document.

However, combining the option of these specific industry modifications with retention of the "substantially related" test in all other cases leaves a lot of open questions.

A substantial part of the problem will not be resolved if non-profit organizations can simply make a slight adjustment to their current methods of operations to once again come under the mantle of a non-profit organization for all of their commercial activities.

Over the last twenty years, the non-profit community has illustrated how successful it has become at operating commercial ventures. It is our opinion that in the absence of a tighter, more effective standard of commerciality, the non-profit community will simply adjust its commercial operations as non-taxable, non-profit activities. Therefore, we strongly urge the subcommittee to be very clear in its definition of a commercial test in non-profit operations.

Forty years of judicial test cases have proven that the substantially related test does not work. To allow it to remain as the final standard, or to replace it with a standard just as weak, would not be an appropriate and effective answer.

Non-profit organizations have been allowed the benefit of the doubt by the tax code and the courts. Their activities have been judged to be substantially related and non-taxable unless the non-profit volunteers to pay taxes on some of its earnings. Even if it volunteers some part of its revenues as taxable, the UBIT statute allows the non-profit other substantial advantages, so that its ultimate taxable income is not consequential.

This is in stark contrast to how the tax law treats the small business community which, in many cases, provides the same products and services. All aspects of for-profit business activity are taxable, with the burden of proof for anything less resting on the business owners. For non-profits however, the burden of proof is on the IRS.

The small business community would be most enthusiastic about a clearly defined standard of commerciality for the non-profit community, which requires the non-profit to pre-qualify each commercial activity for non-profit status and an exemption from UBIT rules.

From the outset, we have stated that it is not the threat of competition which concerns small business owners. For small business competition is a fact of everyday life. Our concern is unfair competition arising from the special privileges and unique status non-profits enjoy.

Last year during the first round of UBIT hearings, NFIB provided a specific list of problems raised by its members, illustrated with thirty examples. We are once again contacting our membership for additional examples of unfair competition and for comments on the subcommittee's options. We will provide the subcommittee with these examples and comments when they are received.

Subsidiaries and Joint Ventures

Many non-profit organizations use their financial base, strength and standing to establish subsidiary firms through which they funnel business. The non-profit will then try to influence its professional affiliates to use the subsidiary.

It is vital to craft a standard under which new subsidiaries must be capitalized, financed, and operated at arms' length, as third party organizations. Once again, however, the standard must be such that the non-profit organizations cannot simply evade their responsibility by shifting ownership among friends.

As in closely-held family businesses, attribution ownership rules must apply in a manner which prevents subterfuge by the owners to attain tax benefits they would not otherwise be entitled to.

IRS Administration

It will be impossible for the IRS or any other agency to understand what is going on inside a non-profit organization in the absence of some kind of reporting requirements which require disclosure of the financial details of each subsidiary. Currently no such standard exists, and the non-profit is only responsible insofar as it has any financial accountability. Even a certified audit is no guarantee that the UBIT standards are being met: the auditor will interpret the standard to meet the best interests of the client, not the IRS.

Conclusion

On behalf of NFIB, we encourage the subcommittee to continue its deliberations to come up with a clearly defined, easily enforced, commercial standard for the activities of non-profit organizations. We believe the subcommittee is going in the right direction with its first proposals, and we look forward to continuing to work with the subcommittee on specific language to take care of the problems and situations highlighted in the discussion draft.

0322T

National Geographic Society
WASHINGTON, D.C. 20036
GILBERT M. GROSVENOR
PRESIDENT AND CHAIRMAN

April 15, 1988

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for extending an offer to the public to comment on the "discussion options" regarding the unrelated business income tax that are under consideration by your Subcommittee.

The outline format utilized for the text of the Oversight Committee's released statement makes it difficult to determine the parameters of some of the "options" to be discussed. Depending on the Subcommittee's intent, my comments may or may not be relevant to the Subcommittee's actual focus of interest.

Under the introductory heading of "I. SUBSTANTIALLY RELATED STANDARD," the Subcommittee paper introduces a discussion of "A. Gift Shops and Bookstores" and thereunder outlines two "Options": On-Premise Sales and Off-Premise Sales. Under the On-Premise Sales Option, it is intended that the unrelated business income tax would not apply to income from the sale of certain items sold by a tax-exempt organization if the sale occurs at a gift shop that is located on the premises of "museums, conservation organizations, zoos, aquaria, historical organizations, etc." Under the Off-Premise Sales Option, unrelated business income tax would apply to "income from all catalog or mail/phone order sales, or other types of 'off-premises' sales."

I am unclear as to the meaning of "off-premise sales" as briefly outlined in the second option. As juxtaposed with the immediately prior discussion of "on-premise sales," one assumes that this taxation option will focus on sales of merchandise by "museums, conservation organizations, zoos, aquaria, historical organizations, etc." which, although they have many on-site visitors, reach a larger audience through mass-mailed catalogs, etc.

If read this way, the "off-premise option" would discuss the attempts by museums, etc., through product sales to attract and have impact on an audience that is unable, by reason of physical distance or whatever, to enter their doors as visitors to their primary educational facility. I do not comment on this reading of the "off-premise option" (though this silence should not be taken as approbation).

Read in a vacuum and not in juxtaposition with the "on-premise" situation of an educational organization that does reach its principal target audience by securing their physical attendance within its halls, one can contemplate an unlikely though not distorted reading of the "off-premise option" to be suggesting that the Subcommittee's focus of interest will be much more general: the potential taxability as an unrelated activity of any sale of any product by any charitable (or even just educational) organization that does not occur on property that is controlled by such organizations.

It is this possible (if unlikely) reading of the "off-premise option" that has prompted me to respond to your invitation to comment on the Subcommittee's discussion paper.

The National Geographic Society is now one hundred years old. The Society has been, from its beginning and throughout its history, first and foremost a membership society. For one hundred years, it has been educating its members (now numbering over 10-1/2 million and located in 170 nations) about geography and related subjects by means of the written word, pictures and maps. Our primary form of communication with our members always has been mail service - in 1986 alone, our membership center facility received 21,595,224 pieces of mail, most of it from our members. Our members receive National Geographic magazine by mail and by mail we offer them maps, atlases, globes and books that we publish on geography-related matters. These publications are available in the United States only to our members. But for a small bookstore that we maintain for the convenience of visitors to our headquarters building in northwest Washington, all sales of the Society's products to its members around the world are, in this context, "off-premise." So it has been for a hundred years.

I do not believe that the Subcommittee intends to focus on this kind of communication by an exempt educational organization with its own members (even when that communication involves sales of books, maps and globes) as an undertaking that is potentially taxable as unrelated business income activity.

As a related point, since 1972 the National Geographic Society has produced and offered for sale to the educational community, through catalog sales, high-quality classroom audio-visual materials: filmstrips, films, multi-media kits and now computer software related to science and social studies topics. Clearly, these are not "museum gift shop items." They are, however, educational products offered for sale by catalog; these products are not available for purchase "on premise" anywhere. Again, I find it unlikely that it is this Subcommittee's intent to focus on this kind of activity as "unrelated" or "insufficiently educational" and therefore subject to the unrelated business income tax. However, your "off-premise option" (at least writ large) presents this possible reading.

I urge the Subcommittee to be dissuaded from serious discussion of a distinction between on-premise and off-premise sales activities of tax-exempt organizations. If, however, the members are of the opinion that abuses in the mail order/phone order area are such that restrictions by taxation are necessary, I would strongly urge the Subcommittee to focus on legitimate distinctions between sales to the general public and sales to an organization's own membership and to the educational community.

There are other "options" listed in the Subcommittee's discussion paper that would, or possibly could, affect the National Geographic Society, depending on the Subcommittee's intended meaning. Because of the potentially far-reaching nature of several of these "options," especially when coupled with our genuine uncertainty over the intentionality of some of the more drastic results, I am reluctant to comment further. The "options" are short-handed statements and the available time within which to comment is short. However, I will sketch our initial observations of a few of the other "options" as outlined:

-- Is there a meaningful difference between the present "substantially related" test for the imposition of unrelated business income taxation and the proposed "directly related" test?

-- To require that each income-producing activitiy "stand alone" in determining entitlement to tax-exempt status suggests a likelihood of "cherry-picking" the revenue-producers from the company of like/kind educationally significant products that are consistently carried at a financial loss.

-- Would the "direct advertising costs" to be applied against publication advertising income be considered the ordinary and necessary expenses of advertising sales?

-- Would the royalty exclusion continue to apply to "products directly related to the exempt function" of an organization when that organization created the property but is marketing it through a commercial entity?

-- Would the new "allocation rule" option be applicable only to "facilities used for exempt purposes as well as unrelated business purposes" or to all "dual use" expenses?

I am recording these questions to emphasize that it is difficult to determine at this point the potential effect of several of the options under discussion. However, regardless of their potential tax impact none of the stated options goes to the heart of the relationship between the Society and its far-flung membership as does a possible reading of the gift shop-bookstore off-premise sales option. For this reason I have limited my comments to this one concern.

I appreciate your serious attention to this letter.

Sincerely yours,

Gilbert M. Grosvenor

NATIONAL GUARD ASSOCIATION OF THE UNITED STATES

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15 April 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The National Guard Association of the United States (NGAUS) is a membership association composed of officers and warrant officers of the Army and Air National Guard. Organized in 1878 as the first constructive meeting between the officers of the North and the South, the NGAUS has had as its primary purpose over this 110 years the nurturing and support of a strong national defense through the provision of a combat-ready National Guard. That remains our goal and our primary mission in 1988.

This letter is in response to the Subcommittee on Oversight's press release dated 31 March 1988 requesting comments on several options relating to the possible taxation of unrelated business income. We oppose any such taxation because it would adversely impact this Association's ability to accomplish its mission in support of a strong national defense and a combat-ready Army and Air National Guard.

The NGAUS is organized and incorporated in the District of Columbia as a tax-exempt 501(c)(3) organization. The major objectives of the NGAUS are to educate the public with regard to the role of the National Guard as a fully functioning element of the Total Force and to make the requirements of the Army and Air Guard known to various elements of the Department of Defense and to members of Congress. As part of our educational activity, we operate, through our separately organized Historical Society of the Militia and the National Guard, a military museum and library that are open to the public without charge.

In order to accomplish the enumerated broad objectives, the NGAUS has organized several sources of income to support its small staff and national headquarters in Washington. Principal sources of income are dues from the 56,000 current and former National Guard officers who constitute our membership, investment income, experience rating refunds from our separately-organized National Guard Association of the United States Insurance Trust, and certain unrelated business income.

Any effort to expand the taxation of this unrelated business income would seriously reduce the revenues available to the elected leadership of the NGAUS to conduct the program mandated by our members. Income from our NGAUS Insurance Trust, from such enterprises as our VISA card through a large Midwestern bank, advertising in our magazine and rental of display space at our conference make a significant contribution to the NGAUS' ability to communicate to our audiences and to promote the combat readiness requirements of our Guard units and members in the 54 states and territories.

In our case, this unrelated business income is truly that. Further, it does not compete in and of itself with other commercial enterprises. There is no real competition for NATIONAL GUARD magazine. It is literally the only publication that reaches a general National Guard audience nationally. An example of our insurance program is the CHAMPUS/Medicare/medical supplement that is directed at Guardsmen who need supplemental medical coverage. Our VISA card, which is for the use of Guardsmen, includes a picture of a Minuteman, the historical symbol of the National Guard.

NGAUS does very little in any active way to promote these enterprises. Rather, they are franchise operations that provide needed service to members of our Association while providing some income to the Association, thus keeping member dues to a reasonable level.

Current law excluding certain unrelated business income from taxation is consistent with sound tax policy in that receipt of such income by an association like NGAUS permits us to perform our educational and information function in a cost-effective and efficient way for our members. Therefore, we are opposed to any change which would result in the expansion of unrelated business income taxes. Thank you for this opportunity to present our views.

Sincerely,

LA VERN E. WEBER
Lieutenant General, NGUS (Ret.)
Executive Director

NATIONAL HEARING AID SOCIETY
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April 14, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Pickle:

The National Hearing Aid Society (NHAS) appreciates the opportunity afforded it by you, Chairman Pickle, and the members of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, to comment upon the preliminary discussion options regarding the Unrelated Business Income Tax (UBIT) released by the Subcommittee on March 31, 1988.

As both a participant and interested observer of the series of hearings held by the Subcommittee in June 1987, NHAS believes the members and staff of the Subcommittee are to be commended for thoughtfully digesting a huge volume of testimony and comment, and issuing a comprehensive package of reform measures. It is the fervent hope of NHAS that the expedient insurance of the aforementioned discussion options is due in part to recognition of the pervasive nature of unfair competition from non-profit entities upon small business and the immediate need to rectify said situation.

INTRODUCTION

NHAS is the international professional association of Hearing Aid Specialists. The approximately 4,000 NHAS members in the United States and abroad are trained and licensed to test human hearing, and select, fit and service hearing instruments. NHAS was founded thirty-seven years ago to ensure the provision of competent professional assistance to the millions afflicted by hearing impairments. As the principal accrediting body for professionals engaged in the testing of hearing, selection, fitting, sale and servicing of hearing instruments, NHAS administers a demanding certification program and conducts study courses and seminars. Historically it has been said that NHAS represents the vast majority of sales of hearing aids in the U.S.

GENERAL COMMENTS

The record developed as a result of the June 1987 hearings by the Subcommittee clearly and abundantly documented widespread entry of non-profit clinics, hospitals and universities into the business of hearing aid sales. Equally well documented was the devastating impact this unfair competition was having on tax-paying hearing aid dispensaries throughout the country. The large number of written comments provided for the record from hearing aid specialists make evident a systematic pattern of abuse of tax-exempt status by those non-profit organizations engaging in the commercial sales of hearing aids.

Among the recommendations under consideration by the Subcommittee are some which specifically address commercial hearing aid sales activities by non-profits. While NHAS naturally endorses these specific remedies, it also recognizes the need for wide spread reform of UBIT across the board. Therefore, NHAS urges the Subcommittee to forward a comprehensive reform package. Only through adoption of such a comprehensive program can the continued vitality of small businesses, such as those operated by hearing aid specialists, be protected while also preserving the long term viability of non-profits. The options being considered strike a chord of fairness and can only facilitate continued and increased participation of small business persons in the charitable endeavors of non-profit institutions.

SPECIFIC COMMENTS (related to the order of discussion options presented in the Subcommittee's March 31, 1988 Press Release)

I. Consideration of several options relative to the continued viability of the "Substantially Related" test: While the suggestion that the "Substantially Related" test be repealed and replaced with a "directly related" test would remove some of the room for ambiguity, it would not eliminate it entirely. Similiarly, while conceptually, individual determination of the tax-exempt status of each income-producing activity standing alone has merit, implementation would likely prove burdensome or unfeasible. Thus, it is the belief of NHAS that the desirable approach is retention of the "substantially related" test with UBIT imposed on specified activities whose nature and scope are inherently commercial, rather than charitable.

One of the specified activities contained in the discussion options states:

> "B. Apply UBIT to all sales/income of medical equipment and devices (including hearing aids, portable X-ray units, oxygen tanks), laboratory testing, and pharmaceutical drugs and goods (with exceptions for:
>
> 1. inpatients, continuous-care outpatients, or emergency treatment outpatients or -
> 2. items not available in immediate geographic area.)"

While NHAS enthusiastically endorses this position, it also wishes to call the attention of the Subcommittee to four points of concern. First, proposing an exception from UBIT application for "continuous-care outpatients" could allow continued abuse by non-profits which engage in hearing aid sales. The nature of hearing health care is such that an individual purchasing hearing aids makes return visits to the dispenser of their instrument throughout the life of the device. These visits for earmold modification, tubing replacement, battery purchase and so on may be construed as classifying the purchaser as a "continuous care outpatient", thus circumventing the intent of applying UBIT to hearing aid sales income. Secondly, it is inconceivable that an "emergency treatment outpatient" would ever be sold a hearing aid and thus, such an exclusion is unnecessary. Thirdly, previous attempts to define patients have given rise to major abuses in non-profit hearing aid sales. Finally, the exception for "items not available in immediate geographic area" begs for clarification of what constitutes an immediate area. While a standard definition may be developed, it would possibly not apply to hearing instrument sales by non-profits, as hearing aid specialists traditionally provided home care for individuals requesting it in an extended coverage area. Moreover, excepting items not available in an immediate geographic area would likely serve as a future barrier to entry for hearing aid dealers.

II. NHAS supports the recommendation that the "convenience" exception for members, students, patients, officers or employees be repealed.

III. Similiarly, repeal of the "regularly carried on" test is also supported by NHAS. These changes would be consistent with retention of the substantially related test subject to the enumerated rules. In addition, income from an activity that is not a trade or business would clearly remain tax-exempt.

V. NHAS would agree with the suggestion that the existing UBIT deduction for certain Section 501(C) organization be increased from $1,000 to $5,000, provided a phase-out beyond the $50,000 income level is stipulated. Limiting the increased deduction to those activities directly carried on by the exempt organization would be prudent.

VII. Regarding the proposed changes in the treatment of subsidiaries and joint ventures, NHAS supports a modification and extension of the definition of "control" of taxable subsidiaries to mean ownership directly, indirectly, or by attribution of at least 50 percent of stock by vote or value in the aggregate. The proposal that aggregates income and activities of subsidiaries to determine if the primary purpose of the non-profit parent is in fact a tax-exempt purpose is strongly endorsed by NHAS. Further, NHAS would be in favor of requiring that no more than a stipulated portion of a tax-exempt organization revenues for a special period be derived from taxable subsidiaries and/or joint ventures.

VIII. The proposal relating to allocation rules, in the view of NHAS, would be strengthened by disallowing eligibility for any deduction if facilities are utilized for both exempt and non-exempt activities. If this suggestion was found impossible, NHAS would favor the discussion option released by the Subcommittee.

IX. NHAS strongly favors the information reporting proposals, in particular the one expanding the 990-T form to include more reporting on activities and income which the organization claims to be exempt or excluded from UBIT. In a similiar vein, NHAS supports more detailed reporting of all revenue-producing activities and income on the 990 Form. The five proposed studies by the IRS appear essential to the program.

In addition, under "IX", we strongly urge the Subcommittee to adopt the recommendation of the Small Business Administration (SBA) that the IRS institute an expedited, administrative channel for the filing and review of complaints relating to the commercial activities of tax- exempt organizations. The protective spirit of UBIT and administrative efficiency of the IRS can be better served if the IRS has access to information targeting potential noncompliance with the law. Tax-paying small businesses are in the best position to identify potential violations of the law, but currently have no formal mechanism to do so.

CONCLUSION

NHAS congratulates and thanks the Subcommittee for developing a series of proposals which together encompass a comprehensive and needed UBIT reform program. As delineated in the discussion options, this program protects the interest of free enterprise and of the non-profit community by returning equity to the tax code, and thus ensures that any competition between the two will be fair. NHAS encourages expeditious action on these proposals.

Respectfully,

James P. Lovell

James P. Lovell
Government Relations Director
National Hearing Aid Society

Chemical Analysis
Research and Development

National Laboratories, inc.
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April 12, 1988

Mr. Robert J. Leonard
Chief Council
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Sir:

I just got the word from one of my sales personnel, that we must bid against a university in Kentucky for an environmental testing contract.

A few years ago, I lost a major Navy contract to a university in Indiana.

I lost a Corps of Engineers contract to another Kentucky university.

Recently, I attended a seminar relating to the OSHA "Right-to-Know" Standard and the SARA "Community Right-to-Know" amendment, and the professor giving the seminar offered to help the industries represented to comply for a "nominal charge." We offer those services for a fee (which can't be nominal).

I do not have free laboratory space.
I do not have "slave labor" in the form of graduate students.
I do not have a taxpayer-supplied main-frame computer.
I do not have taxpayer-furnished laboratory apparatus and instruments.
I have to pay for building space.
I have to buy equipment and instruments.
I have to pay my employees (all far above minimum wage).
I have to pay taxes on my building.
I have to pay taxes on anything I purchase.
After I have purchased it, I have to pay taxes for owning it (whether I use it or not.)
I have to pay taxes on my own salary!
I have to pay taxes on my employees' salaries.
If--after all this--I manage to make a profit!
I have to pay taxes on the profit!

Some of these taxes go to support the universities and "not-for-profit" research institutes who are my competition.

Non-profit and not-for-profit institutions should not be allowed to offer goods and services in competition with tax-paying organizations.

I do not object if non-profit or not-for-profit organizations own for-profit operations. Yet those for-profit operations should be required to be self-supporting, and to pay taxes on any profits generated, and to pay taxes on their purchases. In other words, they should be made to operate like any other business. Any after-tax profits could then be used in support of whatever the sponsoring organization was chartered to do.

Even if the "unrelated business income tax" is reformed, small for-profit testing laboratories are still at a disadvantage since so many tax-free benefits are available to non-profits.

Universities are supposed to provide us with "leading-edge" basic research, and people we can employ. The more the non-profit laboratories compete with us, the lower the fees must be, the fewer people we can employ, and the lower the tax base becomes. The same is true for government-owned facilities (federal, state or local). We should not have to pay taxes to support our competition.

What is true for laboratories is true for manufacturing companies as well.

Any organization that operates a business in the private sector should operate it as a business in its own right, and compete on an equitable basis.

The playing fields have been canted for too long. Let's get them levelled, lest we result in converting them to the Small Business Killing Fields!

Your serious attention to reforming the UBIT rules is solicited.

Cordially,

C. Shultz

C. G. Shultz, Ph.D., P.E.
President

CGS/bjm

Copy: Congressman McCloskey

National Mining Hall of Fame and Museum, Inc.
P.O. Box 981
Leadville, Colorado 80461-0981
Phone: (303) 486-1229

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area code 719

April 8, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Mr. Leonard:

The National Mining Hall of Fame and Museum is a 501 (c) (3) organization, incorporated within the state of Colorado a decade ago, and located in Leadville, Colorado, in 1987. We wish to comment on the issue of taxation of non-profits' revenue-producing activities.

The National Mining Hall of Fame and Museum and the Lake County Civic Center Association's Heritage Museum, both located in Leadville, are classified as non-profit. While our facility is national in scope and the Heritage is dedicated solely to local history, we have much in common and heading the list of commonalities is financial survival in an era when fund-raising is extremely difficult. Whatever "profits" can be gleaned from gift shop/bookstore, specialty items, etc., are immediately put to work in the areas of maintenance, exhibit expansion, wages, utilities and so on and on. We're convinced that this is true of at least 90% of the non-profit organizations in this country. We truly are "non-profit!"

While you may feel that an additional financial burden on the non-profits will eliminate all but the most financially secure and that this would, in no way, effect the balance within the broader community, we disagree. Each and every museum throughout this land plays an economic role within the area that it serves. Close a museum and that not only silences the message that it carries but it also puts an effective end to the base of tourism that brings much-needed dollars into the community. The domino effect is felt.

While we agree that non-profits should report their revenue-producing activities to the government, it should be a fair and equitable reporting of income and expenditures so that it is obvious that the 90% or so really aren't making a profit but are simply trying to maintain the status quo.

If the proposed changes are made, state and local governments are sure to follow suit. This, in all likelihood, spells the beginning of the end of the non-profit status and the certain demise of hundreds of museums that are struggling to accomplish the work that they have been entrusted, by the public, to do. Perhaps only the governmentally-funded museums will remain and, with their presently restricted financial bases, they will then be horrendously overburdened.

The National Mining Hall of Fame and Museum is working diligently to perfect a facility and a program which will educate the public in the importance of the American mining industry. We are in the process of fund-raising and planning for renovation of our 71,000-square-foot building. Every penny at our disposal MUST be used specifically for these purposes. Once we are fully operational, tourism in Lake County is expected to increase dramatically. The domino effect will be felt in a positive way.

Siphoning off any of our anticipated funds would put us just that much farther from the day when we reach that "fully operational" stage. Lake County, Colorado, presently suffering from a depressed economy and epic unemployment due to the collapse of the mining industry, is dependent, to a degree, upon the National Mining Hall of Fame and Museum! We feel very strongly about this responsiblity to our community, as well as to the mining industry as a whole.

We respectfully request that the House Ways and Means Oversight Subcommittee reject any change in the present status of non-profits' revenue-producing activities taxation.

Thanking you for your consideration in this matter, I remain

Sincerely yours,

robert T. Reeder

Robert T. Reeder
Executive Director

Statement of:	National Office Products Association Donald F. Haspel, Executive Vice President
Before the:	Subcommittee on Oversight Committee on Ways and Means U.S. House of Representatives Discussion Options Relating to the Unrelated Business Income Tax April 1988

Mr. Chairman, Members of the Subcommittee, this statement is submitted on behalf of the National Office Products Association in response to the discussion options relating to the Unrelated Business Income Tax released by the Subcommittee on March 31, 1988.

We commend the Chairman and members of the Subcommittee for their considerable efforts to resolve the now major problem of non-profit competition. And we are particularily pleased that the Subcommittee would choose to address the specific competitive problem faced by computer retailers from on-campus college and university sales of personal computers.

First, we believe the option under discussion by the Subcommittee regarding computer sales does address that part of the competitive problem whereby colleges and universities are permitted to sell to non-students and others who have only "vague" connections to the institution. In this regard, the option under consideration tightens up on a situation which is currently out of control.

Unfortunately, we do not believe the exception from UBIT for sales by a university of more than one computer per student or faculty member really addresses the core problem of competition computer retailers face.

Most students and faculty members do not purchase more than one computer per year. Most will only purchase one computer during their entire academic career. It is the multiplicity of sales - the total of those individual sales per student or faculty member - which, in the aggregate, constitute the competition faced by computer retailers.

We ask that the Subcommittee keep in mind that the cost of a computer is not insignificant. When a for-profit, taxpaying business makes a sale, it is contributing to the tax base of its locality and its state at a percentage of the sale price and, ordinarily, at a substantial rate. Such is not the case when universities and colleges are making sales. Continued sales at the non-profit level pull down prices at the for-profit level - thereby pulling down the overall effective tax base of these products.

As we pointed out in our statement to the Subcommittee in June of 1987, a severe consequence of sales by commercial non-profits is price erosion. In the computer industry particularly, computer manufacturers compete aggressively to place their systems in educational institutions. This practice helps vendors cultivate the allegiance of future executives who will recommend their equipment.

As vendors vie for presence in the classroom, they offer discounts to educational institutions which are not made available to computer retailers. Thus, their nonprofit status makes it possible for educational institutions to enjoy special pricing not offered to taxpaying retailers.

As colleges and universities market and resell the equipment, their preferential treatment is reflected in their pricing. Consumers form price expectations which become fixed at an artificially low level, and the price structure of the equipment erodes. Subsequent customer purchases are affected by the nonprofit pricing, and dealer profitability declines still further.

It should be noted that manufacturers trapped in the university selling cycle also suffer. By sacrificing profits for presence in educational institutions, pricing erodes and manufacturer profits decline. Dealers drop manufacturers' lines because they are no longer profitable, and a vicious cycle develops. Customers expect lower pricing, dealers cannot carry products that are not profitable and cannot support products they don't carry.

Vendors face a triple loss: loss of profits, loss of dealer base, and loss of customer support. Customer satisfaction declines as frustrated customers blame the manufacturer and become dissatisfied with the equipment. The manufacturer's reputation and market presence suffer. Ultimately, capital for research and development dwindles, and the competitive strength of the U.S. manufacturer is weakened.

Again, permit me to point out that the taxable base for states and localities unravels in direct proportion to price erosion in the market.

In conclusion, we find the option of limiting one sale per student and/or faculty member per year to be a step in the right direction, to the extent it begins to rein-in a situation now out of control.

But, we respectfully ask that the Subcommittee take the next most important step, and that is to apply UBIT, without exception, to income derived by universities from computer sales. We do not believe that university sales of computers is related to their function, either substantially or directly. Rather, we have tried to demonstrate that no one, other than perhaps universities, really profit from these sales. And, to the extent that universities do gain an advantage, we find an unfairness that should be redressed.

STATEMENT OF DOUGLAS J. BENNET
PRESIDENT
NATIONAL PUBLIC RADIO

Before the Subcommittee on Oversight
House Ways and Means Committee

OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX

Mr. Chairman, I am Douglas Bennet and I am the President of National Public Radio. National Public Radio is a non-profit membership organization; both NPR and its 350 full service public radio station members on whose behalf it files these comments are Section 501(c)(3) organizations which may be directly affected by proposed changes in the Unrelated Business Income provisions of the Internal Revenue Code set forth in the Discussion Options ("Options"). NPR produces and distributes award winning public radio programming including MORNING EDITION, ALL THINGS CONSIDERED, and PERFORMANCE TODAY, and often transmits for broadcast gavel-to-gavel coverage of Congressional hearings. It provides programming throughout America to a wide range of audiences, including such specialized audiences as the Hispanic, Black and Native American communities as well as the elderly and handicapped persons. NPR in these comments focuses attention on those aspects of the Options which may have a particular impact on public radio stations and on NPR itself.

NPR has reviewed the Comments of Independent Sector, and supports them; NPR regards them as part of this Comment and does not repeat the same points.

Support for Expansion of Reporting Requirements

NPR urges Congress to adopt an even-handed approach to the perceived problems of abuse of the benefits of tax exempt status by non-profit organizations. The enhanced reporting requirements proposed in the Options (Options, IX) would be a sound step toward that end, by giving Congress, the Internal Revenue Service, and the public additional information to evaluate the effect of unrelated business income requirements, and by assisting in effective enforcement of those requirements.

Options May Adversely Affect On-Air Fundraising

Public radio stations are supported in part by the listeners they serve. Usually the audience makes contributions to stations during on-air fundraising drives held several times a year. The drives are crucial to a public radio station's ability to attract the 20% of their financial support which comes, on average, from the listening public. Every dollar provided by Congress to public radio stations acts as a multiplier that brings in six to seven dollars more in non-federal sources, including the listening audience. The Options may adversely affect such fundraising in several ways.

First, taxing the distribution of premiums of nominal value (less than $5) (Options, X) incidental to stations' solicitation of charitable contributions is likely to have an adverse effect on NPR's member stations. Premiums are an effective inducement to public contributions. The Option proposal would either discourage their use altogether, reducing the amount the public contributes to public broadcasting to the detriment of services offered; or require detailed bookkeeping and possible payment of taxes -- absorbing valuable dollars -- which would similarly reduce funds available to stations to pursue tax-exempt purposes. Since many of these stations, particularly those that serve small communities, have little financial latitude, the results of such a requirement could be significantly adverse. Public radio is attempting to expand to reach every part of the United States. The results of such a rules change could seriously interfere with that important goal to serve the whole American public. Finally, the distribution of nominal-cost premiums in connection with public radio fundraising does not actively compete with the business community. We, therefore, urge that this Option not be adopted, and that the current standard be retained.

Second, in the event nominal-cost premiums are subjected to tax, repeal of the "regularly carried on" standard (Options, III) would further increase the likelihood that public radio stations could find their on-air fundraising drives subjected to unrelated business income tax. Therefore, we urge retention of this standard, at least until a determination about the nominal-cost premiums is made.

Adverse Effect On NPR Sale Of Public Radio Program Cassettes

Through a catalogue, National Public Radio sells cassettes of its educational broadcasts by mail and by phone. These cassette sales are directly related to NPR's tax exempt functions, including making public radio programming available to the public. Under the Options (Options, IA), since NPR has virtually no on-premises sale of such cassettes, income from these cassette sales would be subject to tax. That result, which plainly undercuts the purposes for which NPR was granted a tax exemption, cannot be what Congress intends. Moreover, the sale of educational broadcast cassettes does not generally compete with the business community. We therefore propose that Congress refuse to adopt the approach which specifically enumerates "inherently commercial" activities without the possibility for analysis of their connection to the entity's exempt purposes.

Adverse Effect Of Provision Taxing Royalties On Internally Developed Property

NPR may pay a royalty to a program producer of the underlying program on a cassette; that royalty may be calculated as a percent of net revenues. Program producers may be NPR member stations which are themselves tax-exempt. Under the licensing provisions in the Options (Options, IV), those tax-exempt stations could be obligated to pay tax on the revenues from these activities, which would again be in direct furtherance of the tax exempt purposes of the stations -- making public radio programming available to the public. In addition, NPR and its member stations commonly license their logos for use on mugs, tote bags, and tee-shirts. They may receive compensation for this licensing on the basis of a percent of net revenues. Under the provisions for royalties on internally developed property, revenue from those products--often used as nominal-cost premiums during fundraising drives--would be taxable. That result would cause serious adverse consequences to NPR and its member stations.

NATIONAL
ROOFING
CONTRACTORS
ASSOCIATION

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(312) 318-NRCA

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

This letter is in response to the Subcommittee on Oversight's press release #16, dated March 31, 1988, in which you solicit comments on a series of discussion options pertaining to unrelated business income tax.

First, I must say that allowing only a 15-day response period for such a comprehensive and far-reaching list of options is, to put it mildly, distressing. As you know, the subject is one that has been a source of discussion for months, and I'm concerned about any efforts to rush anything through at this point.

Second, I'm always troubled by non-specific language that could have ramifications for beyond its intent. In particular, I refer to the final item under Section X:

> "Consider modification of various piecemeal UBIT exclusions enacted since 1969."

If there are items to discuss, let's spell them out and discuss them.

Third, it is my view that many of the "discussion options" go far beyond any of the proposals seriously considered by the subcommittee. The result is that instead of testifying on carefully developed proposals, we are forced into quick responses to new ideas.

For example, Section I. (A) (2) says:

> "Apply UBIT to additional specified activities determined to be inherently commercial."

Aside from it having some obvious problems of clarity and definition, this is a new concept.

Fourth, I offer the following specific comments:

1. Section I. I don't understand the distinction between "substantially related" and "directly related" and would hope that it be clarified before becoming adopted.

2. Section I (J). Allowing tax-exempt organizations to deduct only advertising expenses from advertising income (and not printing costs, for example) would have the effect of putting tax-exempt organizations at a

disadvantage competitively with non-exempt publishing enterprises. It's hard to imagine that this would be the intent of Congress.

3. Section III. For the most part, tax-exempt organizations form controlled taxable subsidiaries in order to comply with tax law, and to have a clear mechanism for doing so. Modifying the definition of "control" would only confuse the issue, and make a clear understanding of compliance more difficult.

Further, UBIT calculations for exempt organizations (in particular, magazine subscription income formulas) are already a huge burden, and forcing a comparison of income between the subsidiary and an exempt parent, as proposed, would once again put tax-exempts and their subsidiaries at a distinct disadvantage.

Also, the proposal to "aggregate income and activities" of controlled subsidiaries to determine tax exemption is a dangerous one. It is not unusual for a perfectly legitimate, tax-exempt organization to realize significant income from activities for which it is perfectly willing to pay tax at the same rates as apply to non-exempt organizations, through a subsidiary. But to suggest that these could or should threaten tax exempt status misses the point.

And the point is that there is a valid societal reason for exempting organizations from income tax when their purposes are largely educational, charitable, or for the general welfare of a large class of people. If that is a valid point, then let's not chip away at that exemption through imprecise rules, and, more important, let's not develop rules that will defeat the purpose of exemptions by putting exempt organizations at a competitive disadvantage.

Sincerely,

NRCA

William A. Good, CAE
Associate Executive Vice President

STATEMENT OF

WALLACE F. TILLMAN

SENIOR REGULATORY COUNSEL

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. Chairman and Members of the Subcommittee. The National Rural Electric Cooperative Association (NRECA) submits these comments in response to the House Ways and Means Oversight Subcommittee Press Release No. 16, dated March 31 regarding "discussion options on the unrelated business income tax." NRECA commends the Subcommittee for affording the public the opportunity of commenting on the Subcommittee's discussion options regarding the unrelated business income tax (UBIT).

NRECA is the national service organization of more than 1,000 rural electric systems providing central station electricity to more than 25 million consumers in 2600 of the nation's 3100 counties in 46 states. In 38 of the 46 states where rural electric systems are located, there are statewide associations which represent members' interests. Generally, the rural electric systems provide service to consumer owners on a cooperative basis in the less densely settled areas of the country, averaging 4.1 consumers per mile of line, as opposed to the more commercial utilities, with 35 to 60 consumers per mile. Almost all of NRECA's members, including itself, are tax exempt, either under 501(c)(12) of the Internal Revenue Service Code, or as is the case for NRECA and the statewide associations, under 501(c)(6). All are subject to the UBIT on business activities not substantially related to their exempt purpose.

It is well known to this Subcommittee that, prior to 1950, all income of a tax exempt organization, regardless of its source, was exempt from federal income taxation as long as the profits derived were dedicated to the organization's exempt purposes. In 1950, Congress was pursuaded that certain tax exempt organizations were engaging in unrelated business activities involving unfair competition with tax paying entities. The 1950 amendments did not affect rural cooperatives, but the Tax Reform Act of 1969 extended the unrelated business income tax to them. Obviously, the focus of the UBIT has been on unfair competition with tax paying entities, and continues to be. What is questionable, however, is whether the law currently is not working or whether it is not being enforced. NRECA is inclined to believe that it is the latter.

NRECA would like to make the following comments concerning the Subcommittee's discussion options:

Substantially Related Test - NRECA supports the maintenance of the substantially related test, which is workable and understandable. The lessons of the Tax Reform Act of 1986 should dictate that Code modifications be made only to the extent necessary. Drastic changes only lead to confusion. If there are abuses that warrant drastic remedies, then such changes are appropriate. NRECA, however, questions whether that is the case here. The questions which the Subcommittee should address are: Is there a problem? If so, what is the problem? Finally, what is the solution? NRECA contends that the substantially related test is workable, but perhaps enforcement has been a problem, and endorses the Subcommittee's attempts to clarify the UBIT provisions to assist in that enforcement. NRECA concedes that the activities of its members and of itself have generally been clearly related to their exempt purpose, presenting relatively few problems. The activities of trade associations such as NRECA are perhaps less clear, but we believe that there are precedents to guide the IRS, and that these precedents are adequate to prevent abuses. Enforcement appears to be a problem, which might be alleviated by increased staffing at the IRS.

Of the Subcommittee's 12 options to tax only certain activities "whose nature and scope are inherently commercial, rather than charitable," NRECA would like to offer comments on Item J, "Apply UBIT to advertising income and allow deductions from UBIT only for direct advertising costs." First, neither NRECA nor any of its member organizations is organized under the Tax Code as charitable organizations, and if the UBIT is limited to those organizations, we are not in a position to comment. If, however, the UBIT would apply to trade associations, such as NRECA and its various statewide organizations, we have problems with the proposals. According to NRECA's Director of Finance and Administration, NRECA is currently able to reduce the net advertising income of the Association's magazine by the net readership costs (subscription income less readership costs). He further adds that publications operating "for profit" are able to reduce their net advertising income by the net readership costs to arrive at net taxable income. Under the proposal, if we understand this application correctly, for profit publications would have a tax advantage over publications operated by tax exempt organizations. Furthermore, it should be emphasized that association publications are generally for their members, and offer news and information not otherwise offered by a for profit enterprise. Certainly, if the Subcommittee is concerned with unfair competition between profit and nonprofit publications, its concerns would generally not be warranted in the case of trade association publications. Finally on this point, NRECA would like to endorse the comments of R. William Taylor, President of the American Society of Association Executives (ASAE). Mr. Taylor comments that "a major purpose of trade and professional associations is to provide their members with relevant and timely information. Publications are an integral part of this process."

Deduction from Taxable UBIT - NRECA endorses the Subcommittee's proposal to increase to $5000 or $10,000 from $1,000 the UBIT deduction. While the phase-out beyond the $50,000 income level will prevent its benefiting NRECA, it will help smaller associations, such as NRECA's various statewide organizations, and possibly, the rural electric cooperative members of NRECA themselves. Subsidiaries and Joint Ventures - NRECA would like to express its concern about the proposals relating to subsidiaries and joint ventures, especially the proposal to "aggregate income and activities of controlled subsidiaries for the purpose of determining if primary purpose of parent is a tax-exempt purpose." The formation of taxable subsidiaries is driven by legitimate concerns which don't include tax avoidance, otherwise the subsidiary would not be taxable. NRECA believes that subsidiaries should not be discouraged where the income produced contributes to the exempt purpose of the parent organization.

Allocation Rules - The Subcommittee proposal relating to allocation rules also causes NRECA concern. NRECA and some of its member systems own their own buildings and, in many cases, rent a portion of them. This is generally done for a period of time as the organization grows until the entire building can be used. This proposal discriminates against the nonprofit entity, since for profit organizations which own their own buildings and rent a portion of them are allowed deductions for depreciation and overhead.

Apply UBIT to Other Activities - NRECA would also like to express its reservations about proposals to apply the UBIT to certain other activities. It is not clear how seriously these are being considered since they were not mentioned in the Subcommittee Press Release, but have appeared in other documents.

First and most importantly is the proposal to repeal the provision enacted in 1980 providing that pole rental income would not be subject to the UBIT. In fact, the example states that "UBIT would apply to income of a mutual cooperative electric company from the lease of the right to use its telephone poles to carry cable TV wires." First, we should note that NRECA members have no telephone poles, but assume that this tax would also be applied to electric poles. If such is the case, NRECA strenuously objects to this proposal, especially since it has always been the position of the Association and its members that such rentals are substantially related to the business of providing electric service. When legislation was passed in 1980, adding the pole rental exemption to 501(c)(12), it was not because such rentals were believed to be legitimately subject to UBIT. It was to avoid expensive and protracted litigation around the country. At the time the legislation was passed, the issue was before the Federal District Court for the state of Oregon in an action by a co-op against the IRS, asking that it return monies paid under protest. Neither a loss nor a victory in the case would have resolved the issue, since a decision in the federal court in Oregon would not have been binding in other federal court districts. As NRECA stated in its testimony before the Ways and Means Committee in 1980: "It is inconceivable to systems that an activity carried on since the 1940s and examined by the IRS in numerous instances could suddenly be determined to be unrelated and subject to income tax." It was also noted that pole rentals are an activity carried on by every segment of the electric utility industry. Additionally, it should be noted that Deputy Assistant Secretary of the Treasury (Tax Legislation) Daniel I. Halperin, in testifying before the Subcommittee on Select Revenue Measures of the Ways and Means Committee on June 26, 1980 stated: "The Treasury does not oppose exempting pole rental income from the unrelated business tax."

Finally, NRECA would like to express its reservations about a proposal to change the tax treatment of association trade shows. Trade shows are integrally related to the tax exempt purposes of the trade asssociation, and to the providing of services to its members. Furthermore, this activity in no way competes with tax paying entities.

One final point we would like to make concerns the rural development activities in which many of NRECA's members engage. As the Subcommittee is undoubtedly aware, the rural communities are facing dire economic pressures. Since rural electric cooperatives have always been a great deal more than utilities providing electric service, they are involved in activities that go beyond the furnishing of electricity. Examples include water and sewer projects, garbage collection, health care, industrial development and telecommunications services. It is important to note that cooperatives become involved in these types of activities because there is a need not being fulfilled by the private sector. Subjecting such activities to UBIT could negatively affect cooperatives' willingness to become involved in the provision of these services. Changes to the UBIT, which would discourage such activities, is not in the public interest, nor would they meet the avowed purpose of taxing activities which unfairly compete with tax paying entities.

NRECA appreciates the opportunity of providing its views on the Subcommittee's examination of the UBIT issue. Should the Subcommittee desire further information, we will be happy to assist in any way that we can.

STATEMENT OF THE

NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Mr. Chairman, members of the subcommittee, the National Telephone Cooperative Association (NTCA) is the primary telephone industry organization dedicated entirely to representing and serving the interests of the nation's rural independent telephone systems. NTCA represents more than 450 small, independent cooperative and commercial telephone companies located in 42 states.

Our comments on the subcommittee's discussion options relating to the unrelated business income tax of aggregate income and activities of subsidiaries are made on behalf of the nation's 250 tax-exempt telephone cooperatives.

History of Rural Telephone Cooperatives

Rural telephone cooperatives are in business to provide their subscribers telecommunications services at rates and quality levels that are comparable to those received by urban subscribers. The areas in which these cooperatives operate are so remote and so difficult to serve that it is most difficult to provide parity of communications services to those enjoyed in urban areas. The commercial giants of the industry found it economically infeasible to provide communications service to the most high-cost, sparsely populated regions of America; thus, the origin of non-profit, service-at-cost telephone cooperatives.

Telephone cooperatives began operation in the early part of the century when hundreds of independent companies were formed. Many of these systems were crude and not maintained or improved as the plant wore out or became obsolete. The rural depression which began in the 1920's contribued to the demise of hundreds of these cooperatives. By the end of World War II, less than 40% of rural homes had telephone service.

Congress recognized the need to foster the formation and expansion of rural telephone service. It passed amendments to the Rural Electrification Act in 1949 which provided a stable source of low cost capital for the modernization and construction of small rural systems. Cooperatives are an important element in fulfilling the congressional purpose of the RE Act "...that adequate telephone service be made generally available in rural areas..." (7 USC § 921).

Congress also enacted § 501(c)(12) of the Internal Revenue Code which exempts from taxation the income of telephone cooperatives only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses in providing telephone service, the exempt activity.

Telephone cooperatives are subjected to unrelated business income tax on business activities not substantially related to the provision of communication service. In addition, they lose their income tax exemption for the particular year by providing to non-members either related or unrelated services that produce revenues exceeding 15% of total gross cooperative income.

Rural Economic Development

America's rural sector has undergone a period of great turmoil as the struggle to redefine the economics of agriculture continues. Witness the abandoned farms, failed agribusinesses and the outmigration of rural residents and the disappearance of rural communities.

In the middle of the rural crisis lie NTCA members and other small businesses who are trying to provide services for commercial and residential use. Small and rural telcos have always been more than "the telephone company." They sprang from a community need for telephone service and have progressed in concert with the local economy and the achievements of their subscribers. The presidents, managers and members of the board of directors of telephone cooperatives are long term members of - and often leaders in - the communities they serve. Consequently, the forces leading to the plight of American farmers and the rural economy have had far reaching implications for telephone cooperatives.

During this period of financial hardship, these companies have endeavored to maintain quality telecommunications service and search for economic solutions for the communities they serve. Since 1961, rural telephone systems have helped start and expand more than 24,000 new commercial, industrial and community facility projects, producing nearly a million new jobs. Rural telephone systems themselves employ more than 30,000 full-time workers.

To promote rural economic development some cooperatives have taken the following steps to attract economic development to their service area:

(1) invested in a state-of-the-art digital switching system for rural exchanges;

(2) invested in new district-wide paging and cellular systems to provide jobs and attract growth;

(3) appointed an employee to monitor several state and federal projects of interest to the area and to assist in an organizing effort to bring new industries to their area;

(4) committed to work closely with their State Department of Economic Development.

Other activities telcos are are cellular telephone, land mobile radio, paging, cable television and satellite programming. Still another area cooperatives are considering entering are refuse removal and providing sewer and water to their service areas.

Rural telephone cooperatives, by the nature of their business and the community leadership of their managers and board of directors, have a vested interest in helping to achieve economic prosperity in their communities.

Congress has indicated its interest in promoting rural economic development by the establishment of a Rural Economic Development initiative under the Rural Electrification Administration. In addition, the idea of the federal government and local interests forming a partnership to work toward economic recovery in rural areas is receiving much attention before Congress this year.

The industry is currently undergoing a period of deregulation under which government agencies encourage telephone systems to diversify their operations. This has stimulated our interest in rural development.

Unrelated Business Income Tax Consideration

Many telephone cooperatives would like to become more involved in rural economic development by diversifying their operations. However, there is concern that if cooperatives continue to diversify their operations they will generate gross income that will cause them to lose their income tax exemptions on their principal telephone service mission or obligation. If income generated from such rural economic development activities is considered non-member or non-exempt purpose and constitutes more than 15% of gross revenues for basic 501(c)(12) exemption or the tax-exempt status of the cooperative would be lost. To penalize the cooperative and its subscribers by increasing the cost of telephone service for engaging in the aforementioned endeavors would not only serve as a disincentive for cooperatives to pursue badly needed economic development projects, but would fail to make needed contributions to the tax base at both the federal and state levels.

One solution would be to treat all income derived from any source of non-telecommunications related rural economic activities in the same manner as telephone directory yellow page display listing advertising income. In 1980, § 501(c)(12)(b) of the Internal Revenue Code was amended to allow telephone cooperatives to engage in telephone directory display listing advertising as an unrelated business activity (taxable) while exempting the gross income from the 85% test of § 501(c)(12)(a), i.e., tax all the net income from a UBI activity while omitting the gross income generated by that activity for purposes of the 85% test.

NTCA recommends that § 501(c)(12), the Internal Revenue Code be amended to read as follows:

> "(12)(a) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.
>
> (b) In the case of a mutual or cooperative telephone company, subparagraph (a) shall be applied without

taking into account any income received or accrued --

(i) from a non-member telephone for the performance of communication services which involve members of the mutual or cooperative telephone company,

(ii) from qualified pole rentals, or

(iii) from the sale of display listings furnished to the members of the mutual or cooperative telephone company.

(iv) from any unrelated trade or business activities deemed to be taxable pursuant to § 511 to 513 of Subtitle A, Chapter 1F, Part III of this code.

The effect of this amendment would be that telephone cooperatives would pay UBIT taxes on all the various new non-exempt purpose or non-member activities that they are called upon to provide while the tax exemption of the greater and principal activity would be preserved.

Such an amendment equates rural telephone cooperatives with taxable entities because taxes would be paid on unrelated business activities. This amendment also fulfills the governmental reliance on the taxpayer to develop income producing activities in the economics of rural America; creating jobs and broadening the tax base by enlivening the rural economy.

NATIONAL TOUR ASSOCIATION STATEMENT REGARDING UBIT DISCUSSION OPTIONS

In June of 1987 during hearings held by this Subcommittee, there was an outpouring of concern expressed by a wide range of industries and businesses regarding the commercial activities of tax-exempt organizations. That concern has not abated in the last ten months.

What the Subcommittee heard during its hearings last year was a resounding message that the well intended provisions of the tax code which provide various advantages to tax-exempt organizations have simply gotten out of hand as they relate to commercial activities carried out by those organizations. Due to the growth of the tax-exempt sector, its steady pursuit of new forms of revenue, the subjective nature of many of the provisions of the Unrelated Business Income Tax (UBIT) and various UBIT loopholes, taxable businesses and, particularly small businesses, are encountering very real and very serious problems in the form of unfair competition from tax-exempt organizations.

The various discussion options now under consideration by the Subcommittee address many of the most critical problems which have arisen from the commercial activities of tax-exempt organizations. The options represent potential change and they represent change in the right direction.

The National Tour Association (NTA) represents over 3,100 businesses which make up the group travel industry, including over 500 which actually develop, market and operate group travel services. We have long held a major concern regarding the massive and steady movement of a variety of tax-exempt organizations into the commercial group travel market. For the second consecutive year, in response to the serious financial difficulties encountered by our tour operator members, NTA has designated unfair competition as our top priority issue.

This Subcommittee and its Chairman enjoy the heartfelt gratitude of our members for your continued consideration of this issue and particularly for the options now under consideration for addressing it.

The first set of options, and the ones which strike at the heart of the problem, concern the substantially related test. During NTA's testimony last year, we reviewed the difficulties associated with administering and enforcing the substantially related test. There are no established standards for determining relatedness. Further, and in a group travel context, tax-exempt organizations can argue that virtually any travel service they provide is substantially related to its purpose.

During our previous testimony, we also explained our view that if a particular activity is commercial in nature, then the type of organization choosing to conduct that activity is inconsequential. In order to ensure competitive fairness, the commercial activity should be taxed, whether it is carried out by a tax-exempt or a taxable business.

We were extremely pleased to see this issue, and to a large extent our view of it, reflected in the Chairman's first discussion option.

The Chairman sets forth three possible options in regard to the substantially related test: repeal it and replace it with a "directly related" test; determine whether each income-producing activity standing alone is tax-exempt; or retain the test, but "impose UBIT on specified activities ... whose nature and scope are inherently commercial, rather than charitable."

It is the opinion of NTA that a combination of the first and third of these would serve to establish a fair and equitable basis for the tax treatment of tax-exempt organizations' commercial activity. As we advocated last year, the substantially related test should be repealed. The replacement of it with a directly related test is an appropriate and fair substitute.

However, moving from substantially related to directly related falls short of addressing activities which by their very nature are commercial, and when carried out with the various advantages enjoyed by tax-exempt organizations represent unfair competition with taxable businesses. Therefore, we encourage the Subcommittee to also adopt the Chairman's option which establishes that specified activities which are inherently commercial incur UBIT.

In short, this combination of options would provide that the activities of a tax-exempt organization must be directly related to its purpose and that when the organization chooses to engage in certain activities which are inherently commercial, those activities will be treated in a manner consistent with their treatment when they are carried out by a for-profit entity, i.e. they will be taxed.

This combined approach offers the specifity and objectivity which is now absent from the current substantially relatedness test. Moreover, it establishes fundamental fairness. It maintains the integrity of the various tax-exempt purposes or functions and simply sets forth that an activity must be directly related to the tax-exempt purpose. Further, it acknowledges that some activities are commercial in nature and that those activities should be taxed as a result of their commerciality.

We would note that one such activity specified by the Chairman is tour and travel services. We concur with the inclusion of this among the services which are inherently commercial. We offer no objections to the stated exception regarding "... such services provided by colleges/universities to students/faculties as a part of a degree program curriculum ..." This places the services in a direct relationship to the purpose of the college or university and through providing the service to students/faculty eliminates the commercial nature of the services.

However, we are troubled by the further exemption of "... de minimis sales to non-students/faculty." This would serve to separate the service from the college or university's purpose and by offering the service to non-students/faculty, i.e. by selling it to the general public, transforms the service back to a clearly commercial activity. We find little consolation in the reference to "de minimis sales." A little unfair competition is still unfair competition. Also, we are concerned about the interpretation of "de minimis" if this exception finds its way into law. This could ultimately evolve into a major loophole allowing colleges and universities to continue much of their current level of tour and travel sales to the general public.

On the basis of our position regarding the establishment of a directly related test and the codification of certain inherently commercial activities, we support the second and third discussion options. The convenience exception and regularly carried on test should be repealed. The result would be a very simple and clear cut approach which would hold that any activity directly related to the purpose of the tax-exempt organization, and which is not one of several designated commercial activities, would not be taxed. If the activity, regardless of its convenience and regardless of the regularity with which it is conducted, fails to meet either the directly related test or is among the specified commercial activities, then it would and should be taxed.

An example may serve to clarify these points. In Lexington, Kentucky a church operates a cafeteria. Meals are provided at much reduced prices to church employees and members. However, the church also makes its cafeteria services available to the general public. We would support the church's right to provide tax-exempt cafeteria service to its employees and members as an activity directly related to its purpose. However, providing cafeteria service to the general public is not directly related to the church's purpose and revenue from these sales should be taxed. Also, we note that Chairman Pickle included "adjunct food sales" in his list of inherently commercial activities, but that he adds an "... exception for on-premise services and/or sales provided primarily for students, faculty, employees, members or organization visitors." This approach and the exception conforms with our suggestion.

With regard to "regularly carried on," the same example suffices. The regularity or frequency with which the church operates its cafeteria should be superceded and rendered moot by the directly related test and by the inclusion of food sales as an inherently commercial activity.

The fourth discussion option recommends the application of UBIT to royalties. Royalties represent revenue derived from a commercial activity, and therefore should be taxed, unless -- and as noted in the discussion option -- the royalties are "... for products that are part of the organization's exempt function," and thereby meet the directly related test.

The suggestion of increasing the $1,000 UBIT deduction to $5,000 or $10,000 is problematic. When one considers this option from the standpoint of fair competition, it must be understood that for-profit businesses frequently encounter competition from a number of tax-exempt organizations. The competition faced by one taxable business when viewed in the aggregate, can be sizable. To allow a 1,000 percent increase in that competition could undermine virtually any other positive action the Subcommittee may take.

During NTA's testimony last year, we presented a page from the Sun City Arizona News-Sun. That page included the paid advertisements of three tour or travel companies. It also included free advertising of tour and travel services offered by twenty-one tax-exempt organizations. If those tax-exempt organizations were allowed to generate $10,000 in revenue before they would incur the UBIT, the for-profit businesses could conceivably be facing unfair competition up to $210,000 before those revenues would be taxed.

We acknowledge, however, the financial and manpower limitations facing the Internal Revenue Service (IRS) in administering and enforcing the UBIT. Therefore, as a means of enabling the IRS to concentrate on the more significant and sizeable instances of tax-exempt commercial activity, NTA would support an increase in the UBIT deduction up to, but not exceeding $5,000. Support of this increase is obviously contingent on enactment of the other reforms we are recommending.

The ninth discussion option regarding tax information reporting and IRS administration represents an excellent package of proposals which should be adopted. In the 1987 General Accounting Office (GAO) Report titled "Competition Between Taxable Businesses and Tax-Exempt Organizations" IRS officials indicated, "... it is sometimes difficult to account for the revenue and expenses associated with the unrelated activity." The report also stated, "Data on the evolution and growth of the tax-exempt community, especially with regard to those income-producing or commercial activities that compete with taxable business, are limited." Finally, one of the recommendations presented last year by NTA to the Subcommittee was a call for further investigation and study.

All of these considerations are very effectively addressed in the discussion option which suggests more comprehensive tax reporting by tax-exempt organizations and various related studies. However, we would note -- as we did in 1987 -- that the pursuit of more and better information should not deter the Subcommittee from taking action now on a problem which continues to demand immediate and decisive action.

The first recommendation made by NTA during its 1987 testimony was that the Subcommittee recognize that a problem of unfair competition exists. The discussion options now under consideration do just that. We commend the Subcommittee for its diligence in acknowledging and addressing this issue.

Further, we congratulate Chairman Pickle on his discussion options. Taken as a whole, they establish a tone and tenor of balance and equity. Several in particular, if implemented, would represent significant progress for returning fairness to the marketplace.

Finally, we must reiterate that the problem of competitive commercial activity carried out by tax-exempt organizations is having an extremely adverse effect on many tax-paying businesses. These businesses have been seeking relief from this problem for a number of years. Apparently, we have gained the attention of the Subcommittee. Now it is time for action.

Statement of the
National Wildlife Federation
on Discussion Options
relating to the
Unrelated Business Income Tax
submitted to the
Subcommittee on Oversight
# of the
Committee on Ways and Means
on
April 15, 1988

The National Wildlife Federation appreciates the opportunity to comment on the discussion options concerning the unrelated business income tax outlined in Press Release #16 issued by the Subcommittee on March 31. While we believe that our comments will be helpful at this stage, we would also appreciate the opportunity to address specific legislative proposals once they are drafted. Because the precise wording of provisions of this kind is particularly important, general comments on the basic ideas are no substitute for the opportunity to comment on specific legislative language. For the moment, however, we offer the following recommendations and supporting analysis:

1. The option of replacing the present "substantially related" test with a "directly related" test is difficult to assess or comment on without knowing the extent to which those proposing this change think it would alter current law. The term "directly," in our view, does not differ greatly in meaning from the term "substantially." Thus, the substance of this idea needs to be fleshed out before it can be meaningfully considered. In general, however, the Federation believes that the present "substantially related" test adequately achieves Congress's original objectives in enacting the UBIT. To the extent there exist ambiguities in the "substantially related" test, these ambiguities are not likely to be excised by a mere change of adverb. Rather, problems can and should be addressed by the issuance of proposed regulations following appropriate oversight hearings, such as the hearings you have announced.

The "substantially related" test has evolved over more than 30 years through careful consideration -- by Congress, the courts, the Treasury Department, and the IRS -- of numerous specific situations. This process, which is directly analogous to the common-law process on which we depend for the wise development of much of our law, should, in our view, be allowed to continue. Indeed, it is the Federation's view that many of the alleged "problems" in this area can be cured by enhanced IRS enforcement of existing law, which presupposes sufficient appropriations to enable the IRS to address new situations.

2. Much of the "case" against the "substantially related" test that has been put forward in recent years is anecdotal at best. Although everyone can cite a few isolated examples of tax abuse, it is far more instructive to consider the kinds of issues that actually come up in a typical UBIT audit of a major charity. Such audits, not surprisingly, have produced occasional disagreements between charities and the IRS. But they plainly reveal no systemic problem that cries out for radical tax reform.

The National Wildlife Federation's own experience is revealing in this respect. The Federation was audited several years ago. As a result of that audit, it was necessary to apply to the IRS National Office for technical advice as to whether the Federation's distribution of various nature-education products generated unrelated business income. The application resulted in a detailed examination of the Federation's sale of these products, which include children's books, birdhouses and birdfeeding guides, cardboard models of dinosaurs, water-test kits, children's microscopes, stationery items, and wildlife-related Christmas gifts, toys and cards. These items are selected and offered to the Federation's members and supporters in order to help them (and their children) better understand the natural environment. By giving such nature-related products as gifts, moreover, the Federation's supporters can express to their friends their interest in the conservation of our Nation's natural resources, as well as their endorsement of the Federation's conservation programs.

The IRS technical experts did a careful analysis of the Federation's sales program, including an item-by-item inspection of many of the articles in question. After completing that analysis, the National Office concluded that the Federation's distribution of nature-education products "contributed importantly" to the accomplishment of its tax-exempt purposes, with the result that no UBIT was due. This outcome was altogether consistent with Congress's objectives in establishing UBIT, and the law should not be amended in any way that would produce a contrary result.

The Federation's distribution of nature-related products is integrally related to its tax-exempt mission in several ways. First, these products enhance people's awareness and understanding of the environment by educating them about wildlife. Most of these products, moreover, are distributed just before Christmas -- traditionally a time when people express their support for various charitable causes by making contributions or by buying items like Christmas cards and Christmas seals. In sending gifts that evoke wildlife and the natural environment, the Federation's members and supporters send to their friends and associates a clear message of support for environmental conservation. This "word of mouth" advertising and endorsement advance the work of the Federation, both by maintaining an awareness of the importance of the conservation of wildlife and other natural resources, and by supporting the efforts of the Federation in furthering that cause.

In this connection, it is worth noting that, in all the years we have been involved in the distribution of nature-education materials, no one from the "for profit" world has ever come to us and complained that we are competitive with them or that we have any unfair advantage. Indeed, those business people with whom we have spoken about our program have been surprised by the severe restrictions under which it is operated so as to ensure that each and every item offered will in some way further our exempt purposes. These people have agreed that our program would not be viable as a stand-alone business in anything like its present form.

3. Of the three proposals identified in Option I of the Press Release, the third proposal -- to "[r]etain the 'substantially related' test . . . [but] impose UBIT on specific activities" -- appears to the Federation as the most reasonable. The Federation does not agree, however, that the selection of which activities to tax should depend on whether they are regarded as "inherently commercial" in some abstract sense. Rather, such activities should be subjected to tax only after consideration of their size or scope and of the extent to which they further the achievement of the exempt purposes of the organization in question.

The Press Release, for example, proposes to tax gift-shop/bookstore income to the extent derived from "catalog sales" rather than on-premises transactions (Option I(A)). The Federation strongly objects to this proposal, at least insofar as it applies to our factual situation. As noted above, we have long made catalog sales of nature-education products, ranging from children's books to birdfeeding guides. Our main catalog is mailed shortly before Christmas, in the hope of encouraging people both to make donations and to include wildlife-inspired gifts on their holiday lists. Each catalog is accompanied by a solicitation, urging current members to make contributions and urging prospective members to join.

The distribution of our catalog provides us with an important method of reaching people who might otherwise not take an interest in the Federation or its work. For better or worse, there are people who will take the time to peruse a catalog that would never take the time to read a direct mail solicitation or go into a bookstore. Thus, by distributing a catalog we are able to bring ourselves and our concerns to the attention of a much larger number of people than would otherwise be the case.

Because the Federation's catalog sales are integrally related to its tax-exempt purpose of enhancing public awareness of wildlife and the natural environment, the income from those sales should not be subjected to UBIT. The test for UBI taxability should be the relatedness of the material to the charity's exempt mission, not (as would be true under Option I(A)) the mode in which the material is distributed (e.g., by on-premises as opposed to catalog sales). Indeed, once it is established that the material "contributes importantly" to the accomplishment of an exempt purpose -- as it does in the Federation's case -- a charity fulfills its mission best when it does not limit its distribution to a few on-premises sales, but rather disseminates the material as widely as possible.

For similar reasons, the Federation objects to the proposal to repeal the exception from UBIT for "low cost articles" distributed in connection with charitable solicitations. For many years, the Federation has distributed sheets of wildlife stamps to members and prospective supporters. These stamps both enhance public appreciation of our Nation's wildlife and help stimulate contributions to the Federation. No one has ever suggested that the distribution of these stamps amounts to an unrelated trade or business, and the Federation is concerned that repeal of the "low cost articles" exception could create precisely that inference. Surely the Subcommittee does not wish to make the solicitation of funds accompanied by a sheet of wildlife stamps an unrelated trade or business. The Federation's job, after all, is to increase public awareness of America's wildlife resources and encourage their conservation and wise use.

4. Option III of the Press Release suggests that the "regularly carried on" test of present law should be repealed. The Federation believes this proposal to be unsound. The "regularly carried on" test, as currently interpreted by the Regulations, actually excludes very few activities from UBIT coverage, since an activity that is not "regularly carried on" will rarely qualify as a "trade or business" to begin with. At the same time, the requirement does perform at least one important function: it enables a charity to test a new fundraising idea -- such as a costume sale for a theatre company, or a Renaissance Fair for a music group -- without worrying about the complexities of UBIT. Permitting such experimentation to remain tax-free will not contravene UBIT's objectives, since irregular or one-time activities by a charity cannot possibly create "unfair competition" with private industry.

From time to time, the Federation has undertaken such one-time or irregular fundraising activities, such as a "warehouse clearance sale" a few years ago. While such "warehouse sales" might in future be covered by the "on premises" exception suggested in Option I(A), it would in the Federation's view be preferable simply to exempt such activities across-the-board. The Federation accordingly submits that the "regularly carried on" test of current law should be retained.

5. Option IV identifies two suggestions with respect to the treatment of royalty income. The first is that royalties "measured by net or taxable income" should be subject to the UBIT. This suggestion is presumably based on the notion that a royalty based on net or taxable income involves the exempt organization in a sort of "partnership" with the licensee which uses the asset in its commercial enterprise.

The mere fact that a royalty depends on the licensee's profitability, however, does not make the exempt organization an active participant in the licensee's business. The dividends a stockholder receives obviously depend on the profitability of the corporation's business, but that fact does not change the passive nature of dividend income. There are, moreover, sound reasons for using net income as the measure of a royalty's "value," particularly where new and unproven technology is involved. Because the licensor and licensee will often have no idea how useful the technology will prove to be, a royalty measured by net income may be the most reasonable method of protecting both parties. The key point is that royalty income, whether fixed or variable, is passive income: the charitable licensor does not actively participate in the licensee's business, and there is accordingly no justification for treating royalty income as unrelated business income.

The same objection applies to the second proposal in Option IV -- that royalty income should be taxed whenever the charitable organization created the property being licensed. This proposal comes close to obliterating the basic UBIT distinction between passive income and active business income. Although Option IV proposes -- correctly in our view -- to "[r]etain [the] current law * * * exception for products that are part of the organization's exempt function," the scope of this proposed statutory exception is not clear. Its ambiguity may be illustrated by reference to the Federation's own situation.

The National Wildlife Federation publishes Ranger Rick, a conservation-education magazine for children from the age of six to twelve. The Federation believes that Ranger Rick is one of the most effective educational tools it has developed. Indeed, we believe it may be the most effective conservation education tool ever developed. At the present time, we have an arrangement with the Canadian Wildlife Federation under which the latter publishes a Canadian version of Ranger Rick. Under this arrangement, the Canadian Wildlife Federation pays us a royalty for the right to publish Ranger Rick in Canada. The royalty helps us defray some of the cost of producing the magazine which, by the way, carries no advertising.

As we understand Option IV, the royalty income that we receive from the Canadian Wildlife Federation would not be subject to UBIT, since it would fall within the exception for "products that are part of the organization's exempt function." Any other result would be absolutely unjustifiable. The royalty is passive income; it stems from no business or commercial activities on our part; and it presents no conceivable possibility of unfair competition with private industry. Indeed, it would be bizarre to have the publication of Ranger Rick in Canada generate taxable income to the Federation, since the publication of Ranger Rick in the United States is at the core of the Federation's tax-exempt mission -- educating people, particularly children, about our Nation's wildlife and natural resources.

Similarly, the Federation, as noted above, has since its inception produced and issued at least annually sheets of wildlife stamps both as an adjunct to fundraising and as a means of keeping America concerned about its wildlife. Over the years, the Federation has been able, from time to time, to make subsequent use of wildlife art originally created for its wildlife stamps. Sometimes that use has been internal, as when the art is used as the design for a jigsaw puzzle or the cover of a children's book sold by the Federation. On other occasions, wildlife stamp art has been licensed for use by others. For example, reproductions of the Federation's wildlife stamps appeared for many years on the back of packs of sugar distributed in restaurants.

There is no policy justification for treating as unrelated business income royalties received by the Federation for licensing artwork developed by it for its wildlife stamp program. If such artwork had been donated to the Federation -- indeed, if it had been purchased by the Federation -- royalties received for licensing the art would continue to be exempt from tax under the Subcommittee's proposals. It is illogical to require a different result where the art is produced by the Federation itself. Either way, the royalty is passive income earned on an investment, and the basic rationale of the UBIT -- to encourage charities to earn income passively rather than by unfair competition with private business -- demands that such royalty income be immune from tax. And even if the Subcommittee decides to tax some royalty income, the proposed exception for "products that are part of the organization's exempt function" should be interpreted to cover the Federation's wildlife-stamp royalties, since those royalties are integrally related to the Federation's exempt purpose of stimulating concern for America's wildlife.

For somewhat similar reasons, the Federation objects to Option I(I), which would apply UBIT to income from affinity credit card endorsements. "Affinity cards" enable members and supporters of a tax-exempt organization to show their support by using a credit card offered by a bank or other company that is willing to pay a royalty to the organization. A charity sponsoring an affinity card program does not thereby engage in the credit-card business. The royalty income it receives is purely passive. And the program as a whole produces no unfair competition. Any bank or credit card company can make arrangements with any number of charities to offer affinity cards. Such programs allow people of modest means to generate financial support for the charity of their choice. Charity of this sort should be encouraged, not discouraged, by the tax code. The Federation accordingly urges that passive royalty income generated by affinity cards remain exempt from the UBIT.

6. Several of the Subcommittee's discussion options (particularly Option VII) deal with taxable subsidiaries of exempt organizations. The Federation is concerned with these proposals because it owns a majority interest in a taxable printing company. The printing company is primarily engaged in printing for the Federation, but it also serves third-party customers, on a market-price basis. It charges the Federation on the same basis as it charges its other customers. There is no overlap in staff or management between the Federation and the printing company. The printing company -- which the Federation bought to insure a reliable source of service for its own work -- files normal corporate returns, and pays significant taxes.

Given the "fair competition" rationale of the UBIT, one would have thought that such a taxable subsidiary arrangement, rather than being a problem, is a solution that the tax law should encourage. Spinning off unrelated businesses to a subsidiary provides a clear legal separation between the non-profit parent and the active management of the business, and it ensures that the subsidiary pays the same taxes as equivalent businesses with other kinds of stockholders.

The proposal to attribute a taxable subsidiary's activities to its parent for purposes of determining whether the parent's primary purpose is exempt activity violates the basic tax principle of respect for the corporate entity. Moreover, it ignores the fact that, in order to meet current IRS guidelines, a subsidiary cannot be the alter ego of the exempt parent and must have separate management. These guidelines ensure that a subsidiary will not bring about the diversion of management attention that the "primary purpose" rule is intended to prevent. Since a charity's taxable subsidiary will pay normal taxes, and since its management must be separate from that of the exempt parent, there is no reason -- on either "fair competition" or "diversion of attention" grounds -- for the tax system to treat the activities of taxable subsidiaries as activities of the exempt parent.

Even more problematic is the option to tax a subsidiary of an exempt parent as if "the income-producing activity had been carried on directly by the exempt parent organization." This "as if" rule would be highly discriminatory if Congress were to adopt some form of the proposal (in Option VIII) to limit UBI deductions for depreciation and overhead.

Even if the rules for determining taxable income under the UBIT were identical to those applicable to regular corporations -- as they should be -- the "as if" provision would be an administrative nightmare, because of the need to calculate taxes that would be due under totally hypothetical conditions. And it could be still be unfair. For it would result in double taxation of interest, rents and royalties paid by subsidiary to the parent. Such payments are now taxed at the parent level under the special rule (IRC § 512(b)(13)) which taxes such payments by a controlled subsidiary to a parent. Under the "as if" option, they would be taxed again at the subsidiary level since, if the business were carried on internally, there would be no such payments.

The motive for the "as if" rule may be concern that the taxable subsidiary will improperly shelter unrelated business income by carrying on, at a loss, what would be exempt activities if done by the parent. The draconian "as if" rule is unnecessary to deal with this problem, since such costs would not be "ordinary and necessary" expenses of the subsidiary's trade or business, and hence would not be deductible by the subsidiary.

In sum, most of the options dealing with taxable subsidiaries should be rejected. They would severely discourage a structure that fosters equal taxation and fair competition, a structure that is thus entirely consistent with the objectives of the unrelated business income tax.

7. Option VIII proposes allocation rules under which an exempt organization would be denied deductions against UBI for the indirect costs (depreciation and overhead) attributable to the business use of a "dual use" facility. The Federation strongly objects to this proposal. The suggested allocation rules would mean that exempt organizations would not be able to compete on a "level playing field" with for-profit businesses, since the former would be denied deductions to which the latter are entitled. The UBIT is designed to prevent "unfair competition" between charities and commercial businesses; it should not result in charities' paying higher taxes than comparable private enterprises would pay.

The proposed allocation rules would encourage waste via the unnecessary duplication of facilities and systems. Those rules could also have the unfortunate effect of leading some charities to perpetuate activities that are not actually "profitable," simply because they fail to realize that the true economic costs are not being charged to the activities in question. The proposed allocation rules would thus force a well-run tax-exempt organization in effect to keep two sets of books -- one for the IRS, another for internal operations. Since generally accepted accounting principles would probably require exempt organizations to publish financial statements based on economic reality, an exempt organization's publicly available tax return would be at odds with its publicly available financial statements. These difficulties, as well as basic fairness between charities and commercial taxpayers, require that the proposed allocation rules be rejected in favor of rules under which the business operations of charities are allowed the same tax deductions that comparable commercial enterprises receive.

8. Option IX contains various proposals for expanded information reporting to the IRS. The Federation generally supports these proposals. Expanded reporting on Form 990 or 990-T would probably be helpful, so long as it does not impose burdensome paperwork requirements. A short form for small tax-exempt organizations is also a good idea -- an idea that would be especially helpful to the Federation's local affiliates, many of which do not even have paid staffs.

The proposal that "affiliated groups" be required to file a consolidated information return also makes sense, but only for groups of truly controlled affiliates. For this proposal to work, the "affiliated group" must be under common control. Someone must have the legal right to obtain the information necessary to file the required consolidated return.

The word "affiliate," though frequently confused with "controlled subsidiary," in fact has a quite different meaning. The Federation, for example, since it was founded 50 years ago, has referred to its member organizations as its "affiliates." But each of these "affiliates" is, according to the Federation's Bylaws, independent and autonomous. Many of the Federation's "affiliates" are older than the Federation itself; some trace their origins into the nineteenth century. The Federation was, in fact, created by its "affiliates"; while they collectively control the Federation, it certainly does not control them, nor do they control each other. As a result, the Federation does not have and could not obtain the information needed to file a consolidated return with its "affiliates." The proposal to require consolidated reporting should accordingly be revised to make clear that such a return is required only where the affiliates are under the exempt organization's actual control.

Respectfully submitted,

Joel T. Thomas

Joel T. Thomas
General Counsel
National Wildlife Federation
1412 Sixteenth Street, N.W.
Washington, D.C. 20036
(202) 637-3700

NTC

NEBRASKA TESTING CORPORATION

4453 South 67th Street
PO Box 6075 Elmwood Station
Omaha, Nebraska 68106-0075
Phone 402/331-4453

April 14, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Re: Unrelated Business Income Tax

Dear Mr. Leonard:

As a small business, competition from nonprofit concerns is a serious, ongoing problem for the continued success of our business. We are depending on the Subcommittee recommending substantial legislative reform to correct the inequities now in place.

The discussion option to modify rules applicable to organizations "testing for the public safety," is unacceptable. Our firm does important work related to the public health and safety, i.e., school districts, hospitals, public buildings, etc., and we pay taxes on our profits. So do most of our competitors. All testing first should do the same. The exemption for "testing for the public safety" should be deleted.

Sincerely,

NEBRASKA TESTING CORPORATION

Daniel E. McCarthy

Daniel E. McCarthy
Vice President, General Manager

The
Neville
Public
Museum
210 Museum Place
Green Bay, WI 54303-2780
414-436-3767

An educational and cultural resource of Brown County

April 11, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I wish to go on record as being opposed to the numerous "discussion options" currently being considered by the House Ways and Means Oversight Subcommittee on the issue of taxation of non-profits' revenue-producing activities.

Several of the options, including changes to the substantially-related test, royalty exclusion, allocation rates and tour services, if adopted, will have a direct impact on the monies made available to the Neville Public Museum to provide such services as exhibits, educational programs and collections care. In the Neville's case, a non-profit "Friends" group raises money to provide the public services such as exhibits, brochures, publications, special education programming and collections evaluation and equipment. If the "Friends" group has to divert a large portion of their revenue from the Museum into the Federal coffers, then we have two options - reduce programming, or have the slack taken up by increasing the local tax levy through Brown County (the Neville is a County-owned museum). In either case, the public still pays the price either through lack of services which it has been demanding or by higher local taxes.

To a large extent, the proposed changes will probably have a smaller effect on the Neville than on another museum. The impact on other museums, historical agencies and non-profit agencies which are not municipally-run will be much greater. In these cases, without municipal funds to fall back on, either these non-profits will have to reduce services drastically, charge more for them, or go out of operation (in which case the government loses the revenue). Can this nation afford the loss of these services? I think not.

Please reconsider the effect adoption of these options will have on the quality of life enjoyed by this country. The options being discussed are extremely short-sighted and, in the end, no one will win.

Sincerely,

Ann L Koski

Ann L. Koski
Director

ALK:bc

Sales Gallery
Neville Public Museum
210 Museum Pl.
Green Bay, WI 54303

Dear Sir,

I'm writing to you concerning the issue of taxing the profits of museum shops.

The shop that I manage give $20,000 profit to the museum each year for programs and exhibits. The shop is staffed by volunteers as are many such shops across the country.

The museum charges no admissions fees but encourages donations. If my shop was taxed, the staff would have to go out into the community and do more fund raising to make up the loss or charge a fee at the door.

Please consider the impact of this on all the small museum around the country.

Sincerely,

Loretta Murphy

Elizabeth J. Pfeifer
Hidden Acres Lane, Route 2
Denmark, Wisconsin 54208

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

I am opposed to all of the "discussion options" under consideration by the House Ways and Means Oversight Subcommittee regarding the UBIT.

In reference to "inherently commercial", the Neville Pubic Museum of Brown County, Wisconsin depends very heavily on the profits from the Sales Gallery to underwrite exhibits, educational programs, printing costs, etc. We are somewhat unique in that we are partially funded by both public and private funds, along with Sales Gallery profits. The UBIT could cause us additional problems, and perhaps even become a "catch 22". We would have to cut back on our already lean programs, staff and community educational services. The public could end up paying more and more taxes for less and less museum activities.

I do not consider taxing the cultural and educational organizations of the USA a step forward for our citizens, especially our children.

I am submitting this statement as the Chairman of the Governing Board of the Neville Public Museum of Brown County, Green Bay, Wisconsin.

Thank you very much.

Sincerely,

Elizabeth J. Pfeifer

New England Aquarium

Central Wharf
Boston, Massachusetts 02110-3309
(617) 973-5200

April 14, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

As the Executive Director of one of Boston's largest museums/attractions, I feel compelled to comment on the proposed guidelines that would effect the tax status of non-profit institutions.

The New England Aquarium, like many other museums, offers a vital and unique service to the community at large. We have gathered in one place specimens and information that otherwise could only be observed through years of world-wide travel and extensive study. Our exhibits, films, lectures and special programs augment academic curricula for students from the elementary grades through graduate school. A visit to the Aquarium is part of an informal, yet meaningful learning process for adults as well.

The availability of food services, books and other remembrances enhance the quality of a visitor's experience. By offering these services on our premises, we provide an opportunity for visitors to take a break before completing their tour of our galleries. Since an average Aquarium visit can take close to three hours, on-site food service and other amenities provide a great convenience for our patrons--particularly those with children.

In 1969 when the New England Aquarium was created, it was seen as an oasis on Boston's waterfront. At that time the Aquarium's only "neighbors" were rotting piers and crumbling warehouses. It is, therefore, important to view the provision of services in their historical context. Clearly, the remarkable transformation of Boston's waterfront had its genesis, twenty years ago, with risks taken by the New England Aquarium. An entire service industry--one that provides development, transportation, food, real estate taxes and jobs--has grown up around us.

As you may know, at least twenty other cities are now planning Aquariums, not unlike the National Aquarium in Baltimore. These institutions will serve as centerpieces for urban renewal and development. Increased taxation of these institutions could very well cause many of these proposals to be withdrawn.

Last year 1.2 million individuals passed through our doors. Research indicates that our visitors view a trip to the New England Aquarium as part of a comprehensive tour of the City of Boston, with all of its cultural attractions, historic sites, scientific institutions and sports facilities. Both residents and out of town visitors also take advantage of the growing number of restaurants, shops, hotels, businesses and services located in the waterfront area. Clearly, spending is not limited to the Aquarium.

I strongly urge that you reconsider imposing taxes on the non-profit institutions that contribute so much to our nation's economy and education.

Sincerely,

John H. Prescott

John H. Prescott
Executive Director

NEW JERSEY GUILD OF HEARING AID DISPENSERS

979 SOUTH BROAD STREET TRENTON, NEW JERSEY 08611
(609) 599-1739

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April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax

Dear Mr. Leonard:

As attorney for the New Jersey Guild of Hearing Aid Dispensers, I welcome this opportunity to submit these comments on the discussion options relating to the Unrelated Business Income Tax presently under consideration before the Subcommitte on Oversight.

The New Jersey Guild represents more than one hundred Licensed Hearing Aid Dispensers whose lives are vitally affected by the "unrelated" business activities of many "non profit" enterprises. The modern hearing aid dispenser is a competent professional who maintains a business in order to serve the hard of hearing. In terms which pertain to the subject of the subcommittee, our members sales must underwrite both the fixed and operating costs of a small business in order to remain viable. This includes tax on personal property, business property and on business profits. Office income is influenced by the number of patients who are served.

Most Dispensers have established offices in or near a population center which, not by coincidence, is the site of a medical center or university. In recent years, the Dispenser has witnessed the inauguration of hearing aid dispensing as an extension of new patient services at such tax exempt institutions. Without the intervention of government, the entry of publicly funded, tax exempt institutions into direct competition with the Dispenser is an irony of lethal proportions. Since once inside the embrace of the institution (most likely with an associated hearing complaint), the hearing aid candidate is more than likely steered to the in-house clinic for the purchase of the hearing aid. Although the ultimate sale is not consummated with any greater skill than that possessed by the Licensed Dispenser, it is cloaked in tax-subsidies and exemptions. Meanwhile, the Dispenser is left to standard methods of attempting to attract the remaining patient traffic necessary to sustain the business which not only pays Municipal, State and Federal taxes from the proceeds of the same transaction, but which is dedicated to providing the follow-up servicing which is customarily not available at the institutions.

Lest the Subcommittee imagine that an individual's purchase of a hearing aid in the tax-free environment is a benefit which should be preserved in the interest of maintaining low-cost health care for needy citizens, ample evidence exists to the contrary.

Although the initial element of convenience to the hospital patient or university patron may render the patient susceptible to easy institutional "steering" to the point of ultimate sale, experience shows that hearing aid servicing at the same facility is sometimes impossible due to the limited hours of such an institutional clinic and the rotation of personnel.

Finally, although many clinics established withintax-subsidized institutions will claim to have limited their attention to "need" patients, examples exist within our experience to show that serious inquiry and enforcement is non-existent in at least some cases. Needy patients are treated every day by Dispensers in New Jersey. Many programs are available for direct patient aid. These programs have well defined and monitored criteria for inclusion. To treat the needy patient in this manner is to ensure comprehensive follow-up and service.

Having participated in the White House Conference on Small Business and having undertaken individual campaigns to arrest the spread of unfair competition by tax-subsidized entities in this State, the New Jersey Guild has gathered significant evidence supportive of the need for legislative measures to restore balance to the market place within which they are required to function.

Professor Hansmann (UBIT Hearings of 6/30/87 p.209) speaking in support of the commercial non-profits, spoke of the "cross-subsidization" within a non-profit institution as being a means of sustaining less profitable services by offsetting the gains of the in-house commercial activity. This concept needs no explanation. It only needs greater perspective: The cross-subsidization principle needs to work within the economic community, not within the tax-subsidized unit! Allow the tax-paying commercial units to continue to be merchants, and they will subsidize the institutions through their tax payments.

Although tax exemption is not the only factor creating an unfair economic disadvantage, a legislative remedy in the area of taxation addresses the matter squarely and restores at least some measure of balance. Accordingly, the work of the Subcommittee in this area is a source of hope for our membership.

Our review of the discussion options leads the Guild to urge your adoption of the following:

> I. Repeal the "Substantially Related" test and replace it with a "Directly Related" test. This would insure that the incursion into the private sector of an economic activity will be as limited as possible.
>
> Alternatively, within the purview of the Guild, the retention of the Substantially Related test should at the very least be coupled with a specific application of the UBIT to sales of devices as specified in subsection I B. of the outline of options.
>
> II. The Guild urges the repeal of the "Convenience" exception. This catch-all has been heard by Guild representatives as a principal excuse to perpetuate unfair competition by the state supported institutions. It is easily abused due to its unavoidably subjective nature.
>
> IX. Expansion of the reporting requirements will assist in the ability of Government to monitor the

need for further remedies. The recommendation for further IRS studies is also applauded.

X. The Guild urges legislation which would hold to greater scrutiny the activities of subsidized institutions in the leasing or sharing of space in a manner which permits for-profit entities to operate within the institution and to gain the benefits of the subsidized property and related services, even if their sales income is subject to tax. This point was very ably developed by James Lovell, Government Relations Director of the National Hearing Aid Society (Statement, June 1987, p. 133) wherein the "layering" of corporate structures was addressed and placed in context of the escalation of such affairs over the last two decades.

Conclusion

The New Jersey Guild of Hearing Aid Dispensers urges the swift enactment of a body of laws which will help restore balance to the marketplace by limiting tax exemptions to the activities they were intended to foster.

Respectfully submitted,
New Jersey Guild of Hearing Aid
Dispensers

By: George T. Dougherty
Attorney.

New Life
Hearing Instrument Centers

Certified Hearing Aid Audiologist
On Staff

Serving the Hearing Impaired
Since 1954

April 14, 1988

Robert J. Leonard, Chief Counsel
Ways and Means Committee
House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

Upcoming discussions on UBIT are of serious concern to me and our company.

We continually face pricing competion which we deem unfair because those who undercut our needed pricing level are the hospitals. The hospitals operate under a policy which gives no validity to obtaining a return on square footage or dollar investment in equipment and personal training. Those hospitals do not have to return a profit- we do!

The square footage cost in a hospital facility, if it were allocated appropriately, would run easily over $25 S.F. whereas our business can justify only about $12-14 S.F. in order to return a profit. One must ask how a hospital can "pay" more than twice the cost per square for "rental" and continue to sell their services and products less than the commercial community. Oneway - the hospitals don't pay taxes nor do they attempt to get any profit and my tax dollars help support those facilities!

I find it insulting and grossly unfair that my company struggles to provide a good service and product and return a profit at the same time, while my tax dollars support my competition.

Sincerly,

Don Brugman

Don Brugman
(3229 Eastern Ave.)

DB/ds

91 Aquahart Road Suite 113
Glen Burnie, Maryland 21061-3901
(Behind Harundale Mall)
301-760-6777

3229 Eastern Avenue
Baltimore, Maryland 21224-4094
(Across from Haussners)
301-342-4567

THE NOAH WEBSTER FOUNDATION and
HISTORICAL SOCIETY OF WEST HARTFORD, Inc.

227 SOUTH MAIN STREET • WEST HARTFORD, CT 06107
(203) 521-5362

April 13, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
US House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

To the members of the Subcommittee on Oversight, Committee on Ways and Means:

We, the undersigned, strongly oppose the passage of any legislation that would affect the current tax-exempt status of museum shops.

The income generated by our shop is critical to the support of our museum. It provides us with the ability to maintain the many research and educational programs that benefit the 10,000 children and adults who visit the Noah Webster House throughout the year. The enclosed brochure details our education program, which is recognized throughout New England as a model for bringing history to life through participatory activities.

Thank you for your help in defeating any measures that would threaten the existence of America's outstanding repositories of our culture.

Sally Williams
Dr. Sally Williams
Director

Sally Whipple
Sally Whipple
Education Director

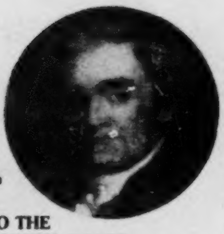
Ruth F. Wessels
Ruth Wessels
President, Board of Trustees

Open the door to our Colonial past through hands-on learning.

NOAH WEBSTER HOUSE

227 South Main Street, West Hartford, Connecticut

NOAH WEBSTER



Author of the "Blue-Back Speller" and the *American Dictionary*, Noah Webster might well be considered the author of our nation's cultural declaration of independence. In his role as "school master to America" and "the father of his country's language," the imprint of Noah Webster's career on the daily lives of Americans is greater than that of many more widely known Americans of the past.

Today, Noah Webster's restored birthplace is not just a hallowed relic of the past. It offers an experience of life as it might have been lived two centuries ago. Authentically furnished, the house represents an excellent example of a farmhouse and family lifestyle that was typical of the Connecticut River Valley in the eighteenth century.

At the Noah Webster House students can explore what their lives would have been like if they had lived around the time of the American Revolution. Each of our educational programs is designed to actively involve students with eighteenth century objects and processes. Our Museum Teachers, dressed in colonial costumes and using first person interpretation, help students to envision life as it was over 200 years ago. They present a hands-on, living history approach to teaching about the past that enables students to develop their critical thinking skills as they explore their New England heritage.

Our programs have been developed with the assistance of local teachers. We look forward to working with teachers to create new kits and programs for students at all grade levels, so please contact us if you have an idea that you would like to develop.

VISITS TO THE NOAH WEBSTER HOUSE

A Sampler of Early American Life

Our overview tour enables students to sample different aspects of eighteenth century farm life through short hands-on activities. During the **Sampler** tour of the Websters' house, your group will explore our 200 year old kitchen, investigate the role of herbs in eighteenth century life, and participate in some of the steps involved in turning raw wool into cloth.

This 1¼ hour program is recommended for all ages, and can accommodate up to 50 students. The fee is $1.50 per student and $1.00 per adult supervisor.

Rhymes, Riddles and Rural Living

Your students will learn about early American farm life by exploring the Websters' house on the **Sampler** tour and participating in eighteenth century games and amusements in our gallery. A wide variety of activities will help your students to understand that colonial life, though difficult, had moments of fun and pleasure.

This 2½ hour program is recommended for all ages and can accommodate up to 70 students. The fee is $3.00 per student and $1.00 per adult supervisor.

A Morning at Noah's

This program, combining a school lesson with a tour of the Websters' house, offers a more complete vision of life as it was for eighteenth century children in New England. Your class will participate in an early American school lesson at the home of America's most famous school master, Noah Webster. In addition to learning their 3R's, your students will also enjoy a special tour of the house, focusing on either fireplace cooking, or a fleece to fabric exploration of the wool process. The choice is yours to make!

This 2½ hour program is recommended for grades 4 and up and can accommodate up to 70 students. The fee is $3.00 per student and $1.00 per adult supervisor.

Town Meeting

Your students will participate in a hands-on tour of the Websters' house and a colonial Town Meeting. During the tour, your class will encounter colonial citizens who are contemplating whether or not eighteenth century Hartford residents should boycott trade with England, due to taxes on tea, glass, paint and other manufactured goods. Following the tour, your students will take on the roles of eighteenth century Hartford citizens to debate the boycott issue in a Town Meeting.

This 1½ hour program is recommended for grades 7 through 12 and can accommodate 20 to 40 students. The fee is $6.00 per student and $1.00 per adult supervisor. This includes a pre-visit session for teachers.

MULTIPLE VISIT PROGRAMS

A Day of Living History

Your students will transform themselves into eighteenth century personages as they take on the roles of real people who lived in Noah's Neighborhood in 1774. Your class will participate in an early American school lesson, do daily chores, spin wool and cook lunch on the Websters' open hearth. Two outreach sessions will prepare your students to understand the terms, objects, activities and people that they will encounter at the museum on the day of their visit. A Museum Teacher will help your students to make costume accessories, learn eighteenth century words, and study inventories left by West Hartford residents over 200 years ago.

The Living History Day series is recommended for grade 5 and up and can accommodate 20-25 students. The fee is $10 per student and $1.00 per adult supervisor. The fee includes a 4 hour museum visit, lunch and 2 1-hour outreach programs.

Colonial Life Unit

A Museum Teacher, in colonial dress, will visit your classroom with our **Intriguing Traveling Trunk** to introduce your students to the eighteenth century. Your class will then come to the Websters' house to explore colonial life through our hands-on **Sampler** tour. Following the general session, a museum teacher will visit your classroom again, this time with games and toys that were once enjoyed by colonial families. This outreach program will be followed by another session at the house, during which your class will be divided into small groups to participate in a variety of hands-on activities, including fireplace cooking, spinning, sewing and working with herbs.

This four-part series is recommended for grade 3 and up and can accommodate 20 to 40 students. The fee is $8.00 per student and $1 per adult supervisor.

IN-CLASS PROGRAMS AND KITS

Our in-classroom programs and kits will help you to explore the past in the comfort of your own classroom.

If you cannot come to us, we will come to you. Our outreach programs are conducted by costumed Museum Teachers who use objects to teach students about eighteenth century lifestyles. These programs are recommended for all ages, and can accommodate up to 30 students in each 1-hour session. The fees are $40 for each one-hour session, $55 for two consecutive one-hour sessions, and $70 for three consecutive one-hour sessions, with a lunch break plus 25¢ per mile.

The Intriguing Traveling Trunk

Your class will have an opportunity to touch the past as a costumed Museum Teacher unpacks a trunkful of eighteenth century objects and uses them to teach about New England life during the colonial period.

Reading, Writing and Cyphering

A Museum Teacher, dressed in eighteenth century clothing, will transform your classroom into an early American school room by teaching the "3Rs" with help from materials familiar to and created by America's foremost schoolmaster, Noah Webster.

Pastime Pleasures

One of our Museum Teachers will help your students to understand colonial life by teaching them the leisure time activities and games that their eighteenth century counterparts would have enjoyed.

Our in-classroom kits include the basic materials and instructions that you will need for teaching hands-on activities to a group of up to thirty students. Our kits can be used either independently, or as introductions or follow-ups to a tour of the Noah Webster House. We charge $15 for a rental period of one week. You can pick the kits up at the Noah Webster House, or have them mailed to your school. Postage and fees can be paid on the day of your visit, or billed with an outreach program.

School Days, School Days

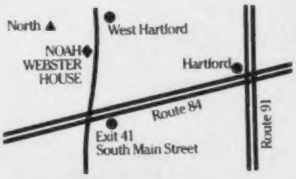
This kit contains the information and materials for teaching and doing papermaking, quill pen writing, book binding and wood block printing. These activities will help students to understand how colonial printing technology affected the nature of early schooling. This kit is a wonderful introduction for students who participate in our Early American School Lesson, either at the Noah Webster House or in your classroom.

Jack Be Nimble

This kit will provide you with the equipment and instructions needed for teaching colonial rhymes, riddles and tongue twisters and playing popular colonial games, such as hoops, la grace, morrice, and button buzzers.

The Man Who Spelled His Way to Fame

Our audio visual slide tape traces the career of Noah Webster, the Connecticut farmer's son who became preeminent in American education and language in the early years of the Republic. This 10 minute film strip is recommended for elementary and secondary school students and can be borrowed for 7 days at no charge.



Arranging Your Field Trip to the Noah Webster House:

Please call our scheduling office, at (203) 521-5362, to make reservations for a visit to the Noah Webster House or to arrange for an outreach program. Please make your reservations before the fifteenth of the month prior to your visit or outreach program.

When you call, please be prepared to:

- schedule your group for a visit during our special school group hours, Monday through Friday, between 9:00 and 1:00.
- tell us how many adult supervisors you will bring. We require that you bring 1 adult supervisor per 10 students.
- advise us of groups or individual students who may have special needs or interests.
- let us know if you want to schedule extra time to shop in our museum store.

The group rates and programs described in this brochure are available only to groups of 10 students or more. Groups of less than 10 students will be charged $20 for a 1¼ hour program and $35 for a 2½ hour program.

Printing courtesy of The Hartford Insurance Group

"Our visit was a most enjoyable learning experience."
"I would really like to live here and do all the things you do!"
"I want to sleep overnight."
"I think you'll probably have a war with England and it will probably be very soon."
"I really felt as though I went back to a different time."

NOAH WEBSTER HOUSE

Operated under the auspices of
Noah Webster Foundation & Historical Society
Of West Hartford, Incorporated
227 South Main Street
West Hartford, Connecticut 06107
Telephone: 203-521-5362

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TELECOPIER: (202) 628-0858
OR-0861
TELEX: 440250

April 15, 1988

The Honorable J. J. Pickle
United States House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515-4310

Dear Representative Pickle:

You have requested public comment on several options to expand the scope of taxable unrelated business income of exempt organizations, which were presented to the Subcommittee on Oversight by its staff. We respectfully request the Subcommittee's consideration of the comments set forth below.

The Discussion Options prepared by the staff of the Committee on Oversight contain provisions relating to the taxation of payments received from controlled taxable corporations (p. 14 of the Discussion Options) and the definition of exempt royalty income (p. 12 of the Discussion Options). Our comments relate solely to these provisions, which need further consideration and refinement. To understand the questions presented by these options, it is necessary to review the development of the concept of unrelated business taxable income of exempt organizations.

Historical Background of the UBIT

The broadest segment of the tax-exempt sector, public charities, includes organizations, identified in § 501(c)(3) of the Code, organized and operated for religious, charitable, and educational purposes. The tax exemption for public charities exists because these organizations serve the general public interest. To the extent that public charities fulfill responsibilities that would otherwise fall upon government, exemption from taxation is warranted. The tax exemption for public charities also serves the public policy goals of encouraging voluntarism and pluralism in American society. See Hopkins, The Law of Tax-Exempt Organizations, 5-13 (5th ed. 1987).

Before 1950 public charities, relying on their tax exemption, were able to earn tax-free income from the active conduct of a trade or business unrelated to their exempt purposes. See Trinidad v. Sagrada Orden De Predicadores, 263 U.S. 578 (1924). Further, the income of a corporation engaged solely in a trade or business, but owned by a public charity, was also exempt from tax under the "destination of income" test. See C. F. Mueller Co. v. Commissioner, 190 F.2d 120 (3d Cir. 1951). Because of their tax exemption, public charities which engaged in the conduct of an active trade of business, directly or indirectly, were seen as unfairly competing with taxable businesses. H.R. Rep. No. 2319, 81st Cong., 2d Sess. 36 (1950). For example, taxable businesses argued that they would be forced to charge higher prices than public charities to achieve the same profit margin. Further, unlike public charities engaged in a trade or business, taxable businesses could expand operations only with the profits remaining after the payment of income tax.

These unfair competition concerns prompted Congress to enact the unrelated business income tax (UBIT) as part of the Revenue Act of 1950, Pub. L. No. 81-814, 64 Stat. 906. Instead of revoking the tax-exempt status of public charities that conducted active trades or businesses unrelated (aside from the need for revenues) to their exempt purposes, Congress merely imposed the regular corporate income tax "with respect to so much of their income as arises from active business enterprises which are unrelated to the exempt purposes of the organizations." H.R. Rep. No. 2319, supra, at 36.[1] The same unfair competition concerns also caused Congress to deny tax exempt status to so-called feeder corporations, organizations operated primarily to conduct a trade or business for profit, the profits of which are payable solely to a tax-exempt organization. See Code § 502. Churches and certain tax-exempt organizations that were not public charities, such as social welfare organizations, were not included in the group made subject to the UBIT.

As a consequence of the 1950 legislation, public charities could still rely upon taxable trade or business income as a source of funds to carry out their exempt purposes. Such trade or business income was, however, subject to income tax to prevent public charities from possessing an unfair competitive advantage over similar trades or businesses conducted by taxable entities. Traditional sources of revenue for public charities remained tax-exempt. Congress generally excluded from the UBIT passive income in the form of dividends, interest, annuities, royalties, and rents. The reason for this exclusion is that passive investments, mere investments of capital in a taxable business, simply do not create concerns about unfair competition. See Statement of Assistant Secretary O. Donaldson Chapoton before the Oversight Subcommittee of the Ways and Means Committee, June 22, 1987.

1969 Legislation

In 1969 Congress reexamined the UBIT. Congress found that some of the unfair competition concerns that prompted the enactment of the UBIT in 1950 had persisted. Several types of tax-exempt organizations not originally subject to the UBIT had begun to engage in substantial commercial activity. Congress also found that the structure of the UBIT unintentionally had served in some cases to foster tax avoidance schemes.

In response to these concerns Congress extended the UBIT to all tax-exempt organizations, including churches, social welfare organizations, and farmers' cooperatives. S. Rep. No. 552, 91st Cong., 1st Sess. 67 (1969). Additionally, in a separate effort to combat tax avoidance,

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[1] If the conduct of a trade or business is substantially related to the performance of the purpose constituting the basis for its exemption, the income earned thereupon is not subject to the UBIT. Code § 513(a). Only if the operation of an unrelated trade or business becomes the primary purpose of a tax-exempt organization will the organization lose its exemption under the Code. Treas. Reg. § 1.501(c)(3)-1(e).

Congress modified the UBIT exclusion for passive income received from a controlled taxable subsidiary of a tax-exempt organization. Congress was concerned that related taxable entities were reducing or eliminating their taxable income by deducting excessive rents, royalties, and interest paid to a parent tax-exempt organization. See H.R. Rep. No. 413 (Part 1), 91st Cong., 1st Sess. 49 (1969). The Senate report provides an illustration of this abuse:

> Some exempt organizations "rent" their physical plant to a wholly owned taxable corporation for 80 percent or 90 percent of all the net profits (before taxes and before the rent deduction). This arrangement enables the taxable corporation to escape nearly all of its income taxes because of the large "rent" deduction.

S. Rep. No. 552, supra, at 73. In response, Congress enacted Code § 512(b)(13) to tax all otherwise exempt interest, annuities, royalties, and rents received by an exempt organization from a controlled subsidiary. Tax Reform Act of 1969, Pub. L. No. 91-172, § 121(b), 83 Stat. 487, 539-40. This is an exception to the general tax exemption for such items of passive income. See Code § 512(b)(1)-(3). "Control" for purposes of Code § 512(b)(13) is defined in Code § 368(c), dealing with corporate reorganizations, and generally means ownership by the exempt organization of 80% of all classes of the taxable subsidiary's stock.

Current Proposals

Taxable Subsidiary Options

In 1987 the Treasury Department proposed a revision to the 80% control test as enacted in 1969 Code § 512(b)(13), consistent with the Discussion Option. Under present law, so long as a tax exempt organization owns less than 80% of any class of stock of the related taxable entity, current Code § 512(b)(13) does not apply. With two classes of stock, the related taxable entity's stock ownership can be arranged to avoid the 80% test. Further, no constructive ownership principles are applied to determine if the 80% control test is met. Accordingly, the Treasury's recommendation and the Discussion Option propose that Code § 512(b)(13) be strengthened by reducing the stock ownership percentage to 50% and by requiring application of constructive ownership principles.

We do not disagree that, without changes, Code § 512(b)(13) is largely ineffective. The Treasury's proposed change in Code § 512(b)(13) and the corresponding Discussion Option, however, fail to address the real problem and would result in unnecessary and inappropriate taxation of truly passive investment income of public charities.

The policy justification for the UBIT was and is the potential for unfair competition that would exist if a tax-exempt organization were permitted to receive tax-free income from the active conduct of a trade or business. Chairman Rostenkowski in his remarks of March 15, 1988, to the Tax Executives Institute made it clear that the focus of the review of the exempt organization provisions by the Oversight Subcommittee is unfair competition with taxable businesses. That review is not intended as a wide-ranging effort to re-examine the entire tax exemption of public charities or as an assault on the exemption of truly passive investment income of such organizations.

There is no tax policy against a publicly-supported tax-exempt organization owning stock, even all of the stock, of a taxable corporation to provide a portion of its operating funds. This is evident from the exclusion of dividends from the UBIT under Code § 512(b)(1) and the fact that dividends are not encompassed by the rules of Code § 512(b)(13). In fact, there are sound policy reasons for inducing tax-exempt organizations to avoid ownership of trade or business assets. The ownership of taxable businesses by separate taxable subsidiaries of tax-exempt organizations allows the tax-exempt organization to concentrate its resources on furthering its exempt purposes. Segregating the trade or business activity also facilitates the determination of tax on the income from the active conduct of the trade or business and protects assets dedicated to exempt purposes from ordinary business risks.[2]

For the same reasons, there is no abuse if a tax-exempt organization leases or licenses property, or lends money in return for rent, property, or interest payments constituting passive income. Taxable businesses regularly pay rent, royalties, and interest for the use of property or money to third parties, including tax-exempt organizations such as pension funds. There is no unfair competition problem in the receipt by a tax-exempt organization of passive investment income from property or money held by it for investment so long as such income is no more than the return which any passive investor would receive for the use of property or money.

The Real Problem of Taxable Subsidiaries

Existing Code § 513(b)(13) violates the fundamental dichotomy between active business income and truly passive investment income in an effort to prevent the siphoning off of active business income without tax. But this is entirely unnecessary. Instead, Code § 512(b)(13) should be completely recast to reach the real problem.

The real problem for tax-exempt organizations controlling taxable subsidiaries is that such an arrangement may permit the taxable subsidiary to avoid tax by characterizing payments to its tax-exempt parent as deductible rent, royalties, and interest, when, in fact, the payments represent nondeductible dividends. Such payments, if they exceed arm's length payments, would cause the taxable subsidiary's taxable income to be understated. With its taxable income understated the taxable subsidiary pays less than its fair share of tax and thereby gains a competitive advantage over other taxable businesses. The solution to this problem it to insure that payments by the taxable subsidiary represent only fair compensation to the controlling organization for the use of its investment property or funds. Traditionally, § 482 of the Code has served this purpose for payments between commonly-controlled taxable entities, requiring that such payments be equal to those which would have been made between unrelated parties dealing at arm's-length. Such a rule recognizes that, absent fraud or collusion, the price negotiated between unrelated parties, dealing at arm's-length and under no compulsion to buy or sell, represents fair market value compensation for use of an asset.

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[2] With the repeal of the destination of income principle in 1950, it is clear that a subsidiary which conducts an active trade or business cannot itself qualify for tax exemption on the argument that all of its profits are distributed to its exempt parent. Code § 502.

Although related parties can never truly deal at arm's-length, their transactions may, nevertheless, be judged by arm's-length standards. If a transaction between related parties is not a sham and satisfies an arm's-length standard, the risk that the arrangement represents an attempt to siphon off active business income without tax in the form of deductible rents, royalties, or interest cannot exist. Furthermore, there is no unfair competition with taxable businesses in such event because taxable businesses must also pay rents, royalties, or interest for the use of property or money belonging to others.

If payments between controlled parties do not meet this arm's-length test, under Code § 482 the Service is to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such commonly-controlled organizations, trades, or businesses "in order to prevent evasion or clearly to reflect the income of any of such organizations, trades, or businesses." The Service's administration of Code § 482 has been eminently successful. Comprehensive regulations exist and the Service has won many major court victories in recent years pursuant to Code § 482. In the Tax Reform Act of 1986, Congress extended the reach of Code § 482 as to royalty payments with respect to intangible property by requiring that such payments "be commensurate with the income attributable to the intangible." See H.R. Rep. No. 841, 99th Cong., 2d Sess., II-637 (1986).

The application of Code § 482 does not turn upon 80% control, or even 50% control, but rather --

> any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

Treas. Reg. § 1.482-1(a)(3).

The principles of Code § 482 should apply equally to payments by a controlled taxable subsidiary to a controlling tax-exempt organization regardless of whether the form of the control is 80% or 50% stock ownership, or some other form. If rent, royalty, or interest payments meet the arm's-length standard of Code § 482, these payments should represent tax-exempt passive investment income to the tax-exempt organization, just as dividends are tax-exempt to such an organization, whether from a controlled subsidiary or a corporation not controlled by such organization.

Code § 512(b)(13) Misses The Mark

Section 512(b)(13) misses the mark by focusing upon the form of ownership rather than the true nature of the payments. Section 482 principles will insure that only true rent, royalty, or interest amounts are treated as such. Any payments in such form in excess of arm's-length payments will become dividends, nondeductible by the taxable subsidiary, thus insuring that such amounts are taxed. These results will follow regardless of the form or degree of control if actual control exists. If actual control does not exist, the payments will necessarily be true rent, royalty, or interest payments since they will result from arm's-length dealings between uncontrolled parties. Further, Code § 482 principles place the focus on the source of the unfair competition: excessive deductions claimed by a controlled taxable subsidiary. Instead of disallowing such excessive deductions, Code § 512(b)(13) currently takes an indirect approach to the unfair competition problem by making all payments from a controlled taxable subsidiary taxable to the tax-exempt parent.

Code § 512(b)(13) has been justified on the ground that a controlled, taxable subsidiary conducting a trade or business is essentially an "agent" of its parent. Because the exempt parent just as easily could have conducted the trade or business without creating a taxable subsidiary, so the argument goes, the taxable subsidiary should not be able to deal with the parent as a separate taxable entity. Accordingly, any rent, royalty, or interest arrangement between a taxable controlled subsidiary and its tax-exempt parent is to be disregarded. This agency principle embraced in Code § 512(b)(13), however, is completely at odds with the general Code scheme for dealings between related parties, which is to correctly calculate the separate taxable income of each party.

If a subsidiary is not a sham and is established for a business purpose, it must be recognized as a separate taxable entity. Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943). The mere fact that a taxable corporation is wholly owned by a tax-exempt organization does not make the taxable corporation the agent of its owner. National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949). While a controlled subsidiary may in rare circumstances be viewed as an agent of its parent, the relationship with the parent must reflect the usual incidents of an agency relationship and must not be indistinguishable from a corporation-sole stockholder relationship. 336 U.S. at 433-34. Even if it could be argued that 100% control suggests the existence of an agency relationship, there can be no doubt that 50% ownership or less would not.

Moreover, under general Code principles, it would not be permissible for a parent corporation to permit a valuable intangible right, such as the parent's name, to be used by a related entity unless a fair royalty was paid. Treas. Reg. § 1.482-1(b). A royalty would be imputed by the Service under Code § 482 to the parent with a correlative royalty deduction to the subsidiary. Treas. Reg. § 1.482-1(d).

The Discussion Option would reverse these general Code principles without necessity or justification. In doing so, the Discussion Option would perpetuate the essential error in existing Code § 512(b)(13) by failing to distinguish between the siphoning off of active business income without tax (to the extent of the rent, royalty, or interest is excessive) and true passive investment income (to the extent it is not). By continuing to focus incorrectly on stock ownership, the proposed change still will not reach cases where there is practical control (even less than 50% stock ownership can represent practical control of a subsidiary in many cases).

Tax-exempt organizations have valid reasons for establishing taxable subsidiaries. Like any other taxpayer, by placing assets in corporate solution, a tax-exempt organization accepts the tax consequences of that choice. Moline Properties Inc. v. Commissioner, 319 U.S. at 439. To the extent Code § 512(b)(13) treats as sham or an agency relationship an arm's-length arrangement between a tax-exempt organization and its taxable subsidiary, it goes far beyond what is necessary to prevent unfair competition. It is conceptually incorrect to tax passive investment income simply because it is earned from a controlled subsidiary.[3]

It bears repeating that unfair competition cannot arise if a tax exempt organization has a subsidiary that conducts an active trade or business and pays an amount for rent, royalties, or interest equal to the amount that would have been agreed to by unrelated parties dealing at arm's-length. Well entrenched tax principles already exist by which transactions may be recast to reflect arm's-length bargaining. Code § 482 is the general model for the Code.

A Proposal to Deal with Taxable Subsidiaries

We propose that in lieu of the Treasury proposal, Code § 512(b)(13) be amended to require a tax-exempt organization and a taxable subsidiary to demonstrate to the Service that any rent, royalty, or interest arrangement between them meets the standards of an arm's-length transaction and is not a disguised dividend. Such a rule would draw upon well-established concepts under Code § 482 to deny a deduction for any non-arm's-length payment by a taxable subsidiary to its tax-exempt parent. Under this approach, an excessive royalty payment, for example, would be recharacterized to reflect the payment that would have been negotiated between unrelated parties dealing at arm's-length for the use of the underlying investment property. Any excess over a fair royalty would be treated as a nondeductible dividend. In this manner, all of the income of a taxable subsidiary would be subject to tax, thereby successfully dealing with the unfair competition problem.

This approach is more carefully tailored to the goal of the UBIT than current law or the option under consideration. Nevertheless, this approach provides the Service flexibility in its enforcement efforts. The control concepts that would be applied are extremely broad and would reach every situation where the deductions for payments made to a tax-exempt organization are overstated or constitute non-passive income. It would prevent avoidance far more effectively than the Treasury or Discussion Option proposals. For example, the attribution rules necessary to implement the proposed 50% control requirement for Code § 512(b)(13) may prove unworkable in an exempt organization context. Traditional attribution principles are based on ownership of stock of related entities. See Code § 318. Tax-exempt organizations incorporated under state nonprofit corporation laws do not issue stock and generally cannot be viewed as owned, in any sense of the word, by an identifiable group. Nevertheless, a tax-exempt organization may very well have such a close relationship with other tax-exempt organizations or entities that their stock ownership should be attributed to the tax-exempt organization.

Further, our proposal would not supplant other anti-avoidance provisions in the UBIT. For example, the debt-financed property rules of Code § 514 would continue to prevent a tax-exempt organization from unfairly competing by trading upon its exemption to acquire business assets with no money down. See H.R. Rep. No. 413 (Part 1), supra, at 44-46; H.R. Rep. No. 2319, supra, at 37, 38-39.

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[3] The Discussion Options (p. 15) also include an option under which the taxable income of a controlled taxable subsidiary can be no less than "its UBIT would have been if it were still in parent exempt organization [sic]." Apart from improperly assuming that a trade or business conducted by a taxable subsidiary was always formerly conducted by the parent, this proposal more clearly reflects the misperception that a subsidiary, a separate taxable entity, is necessarily the agent of its parent. This option does not further the sound policy goals reflected in the UBIT and would constitute an extraordinary departure from accepted tax principles. We recommend that this option be given no further consideration.

To identify possibly excessive payments to which Code § 482 principles should be applied, payments by a taxable corporation, partnership, or trust should be disclosed. For example, such a taxable corporation could be required to file with its return a form or statement on which the amounts of payments of rents, royalties or interest and the identity and taxpayer identification number of tax-exempt payees that own some threshold ownership interest in the payor taxable corporation. The threshold ownership interest should be small (e.g., 25% voting power or value) in recognition of the fact that practical control can exist for purposes of Code § 482 even where nominal ownership is less than 50%. In the alternative, a charitable recipient might be required to file a statement of form disclosing the identity of the paying entity. To avoid imposing unnecessary administrative burdens on both taxpayers and the IRS, where payments to tax-exempt organizations in the aggregate do not exceed some de minimis amount (e.g., $10,000), no disclosure should be required.

Administrative Advantages to Section 482 Approach -- No Intrusion in Religious or Other Exempt Functions

By focusing the solution more directly on the "problem" to be eliminated, which can only be an overstatement of deductions by a taxable corporation, a distinct administrative advantage exists. The taxable entity is the easiest one for the IRS to audit, raising none of the intrusion questions that otherwise could be raised in the case of churches, for example. The taxable entity will receive the bill for any tax deficiency, including interest and penalties, again avoiding any controversy with the tax-exempt organization. Community and political controversy will be far less likely to arise if only the taxable entity's liability and not the tax-exempt organization's liability is the object of any inquiry or dispute.

Royalty Option

Another option described in the Discussion Options is to tax (i) royalties measured by net income (except mineral royalties), (ii) royalties received by an organization that created the property giving rise to the royalty, and (iii) royalties received by an organization that performed substantial services or incurred substantial costs to develop or market that property. Apparently, if a related organization created the property, performs development services or incurs marketing costs, the rules in (ii) and (iii) are satisfied.[4]

The proposal to tax royalties measured by net income was included in the recommendations of the Treasury Department contained in Secretary Chapoton's testimony during the June 1987 hearings. This proposal does not deal with the problem targeted by UBIT, unfair competition, but with the asserted difficulty encountered in distinguishing between taxable active trade or business income and excluded passive royalties. In substance, an arrangement providing for the payment of royalties measured by net income may be largely indistinguishable from a joint venture through which the tax-exempt organization is conducting an active trade or business. In contrast, royalties that do not depend on the amount of, or even the existence of, net or taxable income are clearly passive income, which has always been exempt under the UBIT scheme. For this reason, to the extent it would tax royalties measured by net income, the Discussion Option has merit. It is our view, however, that the Discussion Option should be narrowed in other respects to make the Option consistent with the otherwise sound tax policy of exempting passive investment income received by tax-exempt organizations.

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[4] The first example provided in this Discussion Option describes a royalty received by a University for the use of its logo on t-shirts and sweatshirts. Under the Discussion Option, this royalty would no longer be exempt from tax. The example is puzzling, however, since the University may neither have created the logo nor performed substantial services or incurred costs to develop or market the logo, and the royalty is not stated to be based on net income.

Under the Discussion Options royalties received by tax-exempt organization for the use of goodwill or other intangibles may be subject to tax. We see no policy justification for taxing a totally passive royalty, not based on net income, received for the use of a tax-exempt organization's name. Where payments reflect arm's length dealing such arrangements do not present unfair competition problems. Furthermore, unlike royalties measured by net income, true royalties received for the use of a tax-exempt organization's name or other intangible asset are truly passive investment income.

There seems to be some confusion about the passive nature of a true royalty. In the case of a tangible asset, the price paid or received for its use is called rent. In the case of money, the price paid or received for its use is called interest. In the case of an intangible asset, the corresponding payment is called a royalty. "Rent," "interest," and "royalty" are simply legal terms for economically equivalent types of payment for the use of property or money owned by another person. Rent, interest, and royalty income are typically characterized as passive because the recipient of the income performs little or nothing in the way of services to earn the income - he merely furnishes the use of his tangible or intangible property or money in exchange for the income. Under the exempt organization tax scheme in place since the 1950's, passive income from the use of property is not taxable to exempt organizations; active trade or business income is, however, taxable if unrelated to the purpose of the exempt organization.

A tax-exempt organization may find that its name has significant value. It is not the federal tax exemption that gives value to the organization's name, but the recognition and appreciation of good works the organization performs in the community. Just as a tax-exempt organization may invest assets to earn passive interest or dividends or value available the use of its property to others to earn rents, so should the organization be able to invest a valuable intangible asset such as its name to produce passive royalty income.

Furnishing an intangible asset for use by a third party in return for a passive royalty should be contrasted with the use of an intangible asset by a tax-exempt organization itself in the conduct of an active trade or business. The regulations promulgated under Code § 513, which defines "unrelated trade or business," describe examples in which an exempt organization's use of goodwill or other intangible asset constitutes an unrelated trade or business. Treas. Reg. § 1.513-1(d)(4). These examples reflect the distinction between passive income and income from an active trade or business. In one example, a tax-exempt research organization regularly sells endorsements of various items of laboratory equipment to manufacturers. The fact that endorsements are sold regularly and to more than one manufacturer suggests that the organization is conducting an active business unrelated to its exempt purposes. Other examples include instances in which tax-exempt organizations regularly sell commercial advertising on radio broadcasts or journals otherwise related to their exempt purposes.

None of the examples in the regulations describes a situation in which a tax-exempt organization receives a royalty simply for licensing the use of its name by another entity in that entity's taxable trade or business. The regulations, which determine whether income is from passive investment, or is income from an active trade or business, are based on the quantity and quality of the activities undertaken by the tax-exempt organization. The Discussion Option attempts to greatly extend this concept by proposing to tax royalties received by an organization that sets out to "create" valuable assets or to expend substantial effort or costs to develop or market its assets. Possibly _some_ extension is warranted, but it surely should not extend to a case where an exempt organization simply licenses the use of its own good name for a royalty without any significant development activity or expenditure to create that good name when it arises solely from the good works, the charitable activities, of the organization. The Discussion Option proposal in its present form seeks to make totally passive royalties taxable if they are received from a related taxable entity that is engaged in a taxable trade or business which uses an intangible asset of the tax-exempt parent. But the same royalty received from an unrelated entity would not be taxed.

If a royalty received by an exempt organization is not based on net income, is not related to its own active trade or business, and reflects arm's-length dealings, no tax policy supporting the UBIT provisions is furthered by making such a royalty taxable. Without an explanation of the tax policy to be served, the Discussion Option treats the activities of the related taxable subsidiary as the activities of the tax-exempt parent. As discussed earlier in these comments (_supra_, p. 8), the agency theory implicit in such a result is an extraordinary departure from general principles of tax law. Furthermore, this result is not required to carry out the policy rationale for the UBIT, which is to eliminate unfair competition arising from federal tax exemption.

Conclusion

For all the policy and practical reasons above, we urge the Subcommittee not to adopt the Discussion Options in their present form as to the treatment of controlled taxable subsidiaries and the definition of excludable royalties. If action is needed, the principles of Code § 482 are not only adequate to deal with controlled taxable subsidiaries, but would more effectively satisfy the tax policy concerns underlying the UBIT.

Sincerely,

John S. Nolan
Phillip L. Mann
Kevin L. Kenworthy

Statement By
Peter Swords, Executive Director
Nonprofit Coordinating Committee of New York

I am writing on behalf of the Nonprofit Coordinating Committee of New York (NPCC) to comment on the Oversight Subcommittee's discussion options for changing the unrelated business income tax. The NPCC is an umbrella group devoted to protecting and advancing the interests of New York City 501(c)(3) organizations. It is a membership organization with 275 members. I testified on behalf of our membership before the Oversight Subcommittee on June 22, 1987.

We note that the discussion options go considerably beyond the Treasury recommendations as set forth in the testimony of O. Donaldson Chapoton, Deputy Assistant Secretary for Tax Policy. We further note that many of the Treasury recommendations were accompanied by the strong assertion that efforts should be taken to collect more detailed information about the issues discussed. We are not aware that this information has been obtained and further understand that the Internal Revenue Service is undertaking an effort to systematically collect data on the unrelated business income tax in connection with its Tax Management Compliance Program. We conclude that more should be learned about the facts that underlie these issues before legislative proposals are seriously considered.

Our general proposition is given force by our acute awareness of how precarious the existence of many nonprofits has become due to wide-ranging government cutbacks. To further reduce what small amount of income nonprofits are able to secure by taxing earned income that is not now taxed is a step that should be taken only with the greatest care and an awareness of how many lives it would disrupt - including both those who work for nonprofits and those who are benefit by them.

Related to this last point, we note that there are several options which do not seem to address any questions of competition. These include the suggestion to eliminate the "regularly carried on" rule (discussed below), several of the "royalty" examples, the taxation of low-cost articles distributed as incidental to the solicitation of charitable contributions, the exchange and rentals of membership or donor lists among tax-exempt organizations and certain gambling activities now exempt. As the revenue impact of these changes for the federal government would be de minimis, it is hard to see what the motivation for these options might be. And yet, to the individual tax-exempt organization these changes would have a serious negative effect.

There follows some specific comments on the discussion options. We have only just received these proposals and have not had time to fully consider all of them. We hope you will allow us to make a supplemental submission if, upon further study, we wish to comment at greater length.

I. Substantially Related Standard - We object strenuously to the introduction of the concept "inherently commercial" into the "substantially related" standard. This would appear to be an outgrowth of the suggestion made during the June 1987 hearings that recognition of exemption should be restricted to "purely" charitable activities, i.e., activities that are primarily supported by contributions and rely little, if at all, on earned income from exempt activities. Under this concept, schools that operate with a high degree of efficiency, whose income derives from tuition, or health care facilities, the bulk of whose income derives from fees, or nonprofit educational publishing companies, would be subject to taxation. In this connection we commend to you the recent Third Circuit case that upheld the exemption of the Presbyterian and Reformed Publishing Co. against an attack that it was too commercial. In that case, Judge Adams stated: "[S]uccess in terms of audience reached and influence exerted, in and of itself, should not jeopardize the tax-exempt status of organizations which remain true to their stated goals."[1] It is notable that most of the specific activities mentioned appear to raise questions about "relatededness" more than "commerciality".

[It is our understanding that the option to repeal the "substantially related" test and replace it with a "directly related" test has been dropped. We are pleased by this as the suggestion appeared to us to be totally without merit.]

a. Gift Shops and Bookstores - The off-premise sales option is confusing. Would the tax be imposed only where off-premise income exceeded on-premise income or would it apply to all off-premise income? If the latter, we would oppose the option since there are many things that educational organizations sell that are directly related to advancing their exempt missions.

j.2. Advertising Cost Allocation Rule - We oppose this item since it is contrary to sound tax principles. We know of no where else in the federal income tax system where such an allocation rule exists.

II. Convenience Exemption - We agree that this provision could be usefully repealed.

III."Regularly Carried On" Rule - We strongly oppose repealing this important exception. As we have indicated in earlier submissions, it is very unlikely that nonprofits enter into significant competition with small businesses and, in any event, there has been no evidence of "unfair" competition, e.g., cut-throat price competition and the like. It is axiomatic that for an activity to be competitive it must be regularly carried on and that a "one-shot" occurrence could not possibly amount to competition. Why tax the income from such efforts especially when it is so desperately needed by nonprofits?

IV. Royalty Exclusion - While we believe that there is merit in the position that royalties measured by net or taxable income should not be excluded from UBIT (although we note that Treasury called for more information on this point and we are not aware that such data has been developed), we strenuously oppose limits on the licensing of logos, endorsements etc. As suggested above, there would appear to be no competitive element here, and the revenues involved have to be extremely small, except from the standpoint of the licenser. It is hard for us to see any reason for removing the exclusion in these circumstances.

VIII. Allocation Rules - Here it is proposed that in circumstances where a facility is used both for exempt and UBIT purposes that an allocation of general overhead expenses of the organization and depreciation should be disallowed in computing UBIT. We object to this proposal. It goes way beyond what Treasury recommended and contravenes basic tax policy with respect to allocation of costs. No one questions that the costs that would be disallowed are in fact incurred by the unrelated business. In addition, if there is any competitive element at all involved here, the proposal would shift the rules dramatically against nonprofits. It is therefore difficult to understand the rationale for this option.

As indicated above, we hope that if we decide it would be useful to supplement this communication, this would be acceptable to you.

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[1] Presbyterian and Reformed Publishing Co., v. Commissioner of Internal Revenue, 743 F.2nd 148 at 158 (3rd Cir. 1984).

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North Carolina Museum of Art
Foundation, Inc.

NORTH CAROLINA MUSEUM OF ART

April 11, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

Please accept these comments relating to the discussion within the House Subcommittee on Oversight of options to the present handling of Unrelated Business Income Tax.

Our Museum's Foundation (a 501(c)(3) organization) operates the Museum Shop within the state-owned North Carolina Museum of Art facility at this address. I am the chief administrative officer for the Foundation and also the Director of Development for the Museum. As such I am accountable to the Foundation Directors for, among other duties, the management of the Shop and to the Director of the Museum for all matters relating to the private sector interests of the Museum.

We would regret the imposition of a test for UBIT that might be more restrictive and, consequently, more costly in taxes than the present "substantially related" criteria. Smaller institutions such as this one must include in the Shop as a service to the museum visitors items relating to our collection and exhibitions but not necessarily produced or created by this Museum exclusively. "Directly" as a test would seem to restrict much more narrowly the items allowed to remain tax exempt.

Off-premise sales of items substantially related to the purposes of the institution should remain tax exempt in our view because we serve a statewide constituency in a largely rural state. Though our volume of such sales is quite minor, we feel that access to services from the Museum by mail and through our outreach efforts is sensible and in the public interest.

Many of the examples cited in the Subcommittee's discussions are beyond our experience. While it is the case that all of the after-expenses income from the Shop goes directly into our Foundation and then directly toward the support of our charitable objectives, we continue to operate entirely within the "substantially related" concept and have no desire, despite the dollar incentives, to deviate from this course. In other words, we find the regulations as they stand as a sufficient deterrent to abuse.

Sincerely,

Sam Stone

Samuel M. Stone
Secretary, Museum Foundation

Novak Hearing Center

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

I am the owner and sole proprietor of Novak Hearing Aid Center. 953 East Memorial Blvd., Lakeland, Florida, engaged exclusively in the business of assisting the hearing impaired through testing hearing loss, counselling and dispensing hearing aids and related services. I am writing to protest the increasing competition that I as a small businessman am facing from tax-exempt institutions. In particular, I am confronting competition from the Central Florida Speech and Hearing Center, a "non-profit" organization that enjoys a significant competitive edge because of its tax-exempt status.

The Central Florida Speech and Hearing Center is a non-profit organization organized under the Laws of Florida. Since 1969 the Center had been assisting speech and hearing handicapped and chronically ill persons through vocational, para-medical and educational services. The Center had never directly sold and seldom fit hearing aids to the hearing impaired. Instead, the Center referred persons in need of hearing aids to commercial hearing aid specialists-dispensers in the area, such as myself. In August 1982, the Center decided to sell hearing aids itself in direct competition with local commercial hearing aid dispensers. Once the Center went into the business of selling hearing aids, referrals from the Center to traditional commercial provider sources ceased. January 1982 to August 1982, I received 47 direct referrals from the Center. The previous year in 1981 I received over 60 referrals, since August 1982 no referrals have been forthcoming. Obviously the absence of these referrals has significantly reduced my sale volume. Additionally, I will most likely not serve these people in the future unless they are attracted to my facility through advertisement of hearing aid batteries or repair services.

The Central Florida Speech and Hearing Center enjoys significant advantages over commercial enterprises in competing for hearing aid customers. Commercial hearing aid dispensers compete with each other--through good service, commercially paid advertisement, good customer relations, a good image, and of

953 East Memorial Boulevard • Searstown Shopping Center • Lakeland Florida 33801 • (813) 688 2919

course, the best competitive price we can offer. Our price must cover all of the costs we incur in carrying on our business, which include salaries, rent, utilities, advertising, payroll taxes, federal income taxes and property taxes.

The Center, on the other hand, is an organization that is sheltered by its tax-exempt status. Obviously, the Center does not pay federal income taxes. This in and of itself provides a significant competitive edge in pricing hearing aids. In addition, as a result of its tax-exempt status, the Center is able to receive contributions and donations which provide further significant advantages and these donations of equipment such as mobile testing van, which it uses to increase its market share. Additionally, the Center locates its offices on City owned property paying $1.00 per year lease and also enjoys non profit postal rates, and does not pay city or county occupational licenses. Naturally, they are exempt from state, county, and city property taxes.

The Center solicites donations from local Central Florida service clubs and businesses. I personally have contributed substantially in cash donations or in kind and was influential as a Sertoman in my club's donating several thousand dollars for either direct therapy, hearing aids, or other related office or therapy equipment. Obviously, I don't have the benefit of a direct governmental subsidy of donations of money and equipment. The price at which the Center offers hearing aids to its customers will always reflect these advantages of tax-exempt status and can be adjusted to suit individual situations and can if necessary be lower than the price at which I can offer the same hearing aid or services.

It is important to underscore that there is no difference between the type of service offered by Central Florida Speech and Hearing Center and the type of service offered by my enterprise and other commercial hearing aid dispensers. In all respects the Center operates like any other commercial enterprise. They advertise in the local yellow pages and are listed under hearing aids in the local Chamber of Commerce directory. They serve any customer who walks in to their facility--not just the indigent or disadvantaged who are in need of charity. Indeed it is my understanding that the Center screens its customers on an ability-to-pay basis and has established a sliding scale to essentially charge a so called "competitive" fee to those able to pay full fees in order to provide similar services to those patrons deemed unable to pay full fees or whom do not qualify for state or service club assistance. One might say that a modern day "Sherwood Forest" atmosphere exists, caring for those unable to afford standard fees by charging competitive prices to those who can pay regular prices for services and hardware. The Center even offers Master Charge and Visa as a service to those who might prefer to "buy now and pay later". On several occasions I have telephoned the Central Florida Speech and Hearing Center to refer customers who needed special testing or could qualify for a hearing aid paid for by government sources only to have the Center inquire "who will be responsible for the payment of the bill?" To characterize this type of operations as "non-profit" or charitable is clearly wrong.

I cannot believe that Congress or the Internal Revenue Service in providing for tax exemption for charitable organizations, intended to encourage unfair competition of this kind. If tax-exempt organizations are allowed to compete unchecked with small businesses such as mine, it is inevitable that the small business will not survive and tax dollars to the federal and state government will be lost.. Protected facilities such as the Center, if allowed to continue unchecked, stifle competition. New potential hearing aid dispensers would be discouraged to commerce business where a powerful well established charity funded tax exempt competition had established a similar business.

At some point I will be ready to retire and will attempt to sell my business. I believe that my selling price would reflect this type of competition. Growth and expansion involve hiring employees. I will be more conservative in estimating my potential and thus might well be hesitant to expand my business. Often when a tax-exempt activity expands, it receives volunteer help or cash donations to carry on their charitable work.

I commend the subcommittee for proposing an excellent package of reform measures, I encourage you to include all these measures as stated in its final report. It is vitally important that commercial tax exempt charities and other so-called non-profits to pay the UBIT on all hearing aid sales. Furthermore, the Subcommittee should repeal the existing "convenience" exemption for patients or recognize patients as inpatients only.

Unfair competition is the bottom line of this argument. Charities should be allowed to exist to serve the needy through solicitations, grants and gifts. Allowing non-profits the privilege of competing for 'customers' without maintaining a fair business environment sends a strong one sided message to business people: Stop Supporting those charities that intrude unnecessarily and unfairly into the free enterprise system. I trust your Subcommittee appreciates the impact of this situation and will act accordingly.

Respectfully yours,

Charles J. Novak

Charles J. Novak
BC, NBC-HIS

ODESSA HEARING AID CENTER
817 EAST 7TH
ODESSA, TEXAS 79761
PHONE (915) 337-4102

MIKE WALLIS
Certified Hearing Aid
Audiologist

"So Nice To Hear"

April 12, 1988

Dear Mr. Leonard:

The House Ways and Means Oversight Committee is proposing an excellent package of reform measures of the Unrelated Business Income Tax (U.B.I.T.) system that applies to non-profit organization. We commend the Committee and encourage the passage of all the measures in their final report.

To eliminate some of the current unfair competition by non-profits, we urge that U.B.I.T. will be applied to all hearing aid sales income. The Permian Basin Rehabilitation Center in Odessa and the West Texas Rehabilitation Center in Abilene are agressively selling hearing aids and much of their gross income is from these sales. Presently, our tax dollars are subsidizing them to unfairly put us out of business.

Please repeal the existing "convenience" exemption for patients or, at least, recognize patients as inpatients, only. Please include all the Subcommittee's fine reform measures for U.B.I.T. that applies to non-profit intities.

Sincerely,

Mike Wallis
Susan A. Wallis

Mike Wallis, Susan Wallis

COMMENTS ON UBIT DISCUSSION OPTIONS

Submitted by
Russell C. Shaw, Attorney-at-Law
Thompson, Hine & Flory and
Vice President,
Ohio Citizens' Council
for the
Ohio Citizens' Counsel

We at the Ohio Citizens' Council (OCC) have reviewed the discussion options for dealing with the unrelated business income tax (UBIT).

While we agree with some of the suggested approaches such as repealing the "convenience" exception and improving the various reporting and compliance requirements, two proposals are very troubling.

Especially troubling are the options that 1) repeal or change the "substantially related" test and 2) repeal the "regularly carried on" test. As the state United Way organization in Ohio, we understand the struggles charitable agencies go through in an effort to meet growing service demands while experiencing cuts in state and federal funds.

These agencies serve Ohioans who are homeless and destitute, who are working poor, and who are middle income - but they are all persons who need a helping hand. They are the elderly, the single parent, the troubled youth, the abused child, and the abuser. These are the people who will lose services if either of these proposals, both of which would curb our charities' abilities to augment their funding, is approved.

We believe that it is important in this debate on UBIT to remember why charities exist and why Congress gave them special considerations in the first place. No individual or group of individuals benefit monetarily from charities' find-raising efforts. The people served and the community as a whole, however, do benefit.

As observed by Alexis de Tocqueville in his commentaries on Democracy in America, America is great because America is good and America will no longer be great if it ceases to be good. We believe it is imperative that, with the shifting of the burden for social programs from the Federal government to state and local governments, changes in public policy that impede charitable not for profit agencies from being able to serve the unmet needs of people could inadvertently help make America less good. The public policy issues of how and who are to provide essential human services should be considered by the Subcommittee in arriving at the approaches to be taken with respect to the suggested options.

We are asking agencies to send us specific examples of how the various options would affect their operations. I would be most happy to share that information with the Subcommittee later.

In the meantime, we would ask that the final recommendations of the Subcommittee on Oversight not include changes in either the "substantially related" or "regularly carried on" tests.

Thank you.

T · H · E
OHIO
STATE
UNIVERSITY

Vice President for Finance

381 Bricker Hall
190 North Oval Mall
Columbus, OH 43210-1359

Phone 614-292-9232

April 14, 1988

Robert J. Leonard
Chief Council
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Subject: Subcommittee on Oversight Committee on Ways and Means Request for Public Comments on Discussion Options Relating to the Unrelated Business Income Tax

Dear Mr. Leonard:

The Ohio State University appreciates the opportunity to respond to the Subcommittee on this most important issue of Unrelated Business Income Tax (UBIT). Given the very tight timeframe within which to respond, we have not had the opportunity to study the UBIT discussion options in any depth. The following represents our preliminary observations on some of the issues.

We have several concerns relating to clarification of terminology used, the seeming lack of recognition of the purpose of an exempt organization when determining the taxability of specific activities, the manner and extent of information being considered for routine reporting, and the apparent selective application of tax principles to the calculation of an organizations Unrelated Business Income Tax (UBIT).

Presently the distinction between "substantially related" and "directly related" activities is unclear. The mission of The Ohio State University is "teaching, research and service". We believe that every activity performed on our several campuses is, in some manner, related to our overall goals and objectives. The current definition of "substantially related" and "directly related" leave a considerable amount of room for subjective and perhaps inappropriate decisions.

When considering the option to retain the "substantially related test" and specific activities which would be subject to UBIT, there are several instances where the intent of UBIT would be in conflict with the organization's purpose. These specific activities may be defined as "inherently commercial" but at the same time may be part of the exempt organization's purpose. In the case of veterinary services mentioned in Section I.F., the performance of all phases of veterinary care help to fulfill the requirements of instruction at an educational faciltiy. Applying UBIT to routine testing as detailed in option I.H. does not permit an exception for such testing which is necessary for research.

If "inherently commercial" activities are to be specified, each should be qualified with a phrase similar to the one used in Section I.G., to "apply UBIT... with exception for activities or services operated, but only to the extent necessary in furtherance of the organization's exempt purpose".

The definition of "non-working" property relating to royalty income must also be clarified to permit comment and compliance with the intent of this option.

The matter of "control" as it applies to the inclusion of subsidiary activities in the parent organization appears to be too narrowly defined. The "control" of an organization or activity does not rely solely on ownership. The definition of the management/oversight or decision making body of the organization contributes considerably to determining under whose control the organization falls. Exempt organizations are most generally not established as capital stock companies, but instead consider the decision making body to have control.

The options as presently written suggest some deviations from practical, fair, and concise reporting. In general, UBIT is intended to subject the "taxable income" of an exampt organization to regular corporate taxes. It follows then the the exempt parent organization would be permitted to file a consolidated return for all UBIT activities under its control. The responsibility for deciding whether to include individual activiites for UBIT and the maintenance of the related information for each separate activity would rest with the parent organization. Likewise, the information concerning those activities detemined to be excludable or exempt from UBIT as well as detailed information on revenue sources such as contributions, grants and other funding sources should be maintained by the exempt parent organization as support for potential audit review. To require this as routine reporting would create an excessive mass of information not directly related to the unrelated business income being taxed.

The potential use of "short form" reports relates to the definition of "small organizaitons" and the use of consolidated reports.

These "short forms" may be useful for small exempt parent organizations but should not be considered for individual activities within a larger entity. Each organization should be permitted to file one report, either a "short form" if size permits or a consolidated form for all activities subject to UBIT.

The option presented concerning the "allocation rules" contradicts the intention to tax unrelated business income as if it were a corporate entity.

To maintain this corporate approach toward taxable income necessitates the allowance of all deductible expenses associated with the generation of the revenues. This includes the direct operating costs mentioned (e.g. maintenance, insurance and utilities), and also all other routine corporate costs without which the revenue would not exist (e.g. depreciation of facilties, administrative costs in the form of overhead). To disallow selected costs normally allowed in corporate taxation would distort the net financial benefit or loss derived from activity.

We are willing to further discuss any of the issues contained in this letter.

Very truly yours,

Weldon E. Ihrig
Vice President for Finance

WEI/mjs-321

SUBJECT: Testimony for Consideration by the Committee on Unrelated Business Income Tax (UBIT)

FROM: Crawford Lincoln, President
Old Sturbridge Village, Sturbridge, MA

DATE: April 11, 1988

As the Chief Executive Officer of one of the nation's largest living history museums (a 501(c)3 organization) with a budget of approximately $10 million and annual attendance in excess of 550,000, I write to express grave concern about several of the options you are considering for changing the rules relating to the unrelated business income tax.

The retail activities engaged in by Old Sturbridge Village have long met the IRS "Substantially Related" test and in the year just completed, produced for the museum a return of approximately $700,000 which provided direct support for museum program activities. With a payroll of $5.5 million allocated to approximately 600 full- and part-time employees, we simply cannot operate this living history museum if our nontaxable sales were to be limited to on-premise purchases by the public of low-cost mementos. Our museum bookstore, for example, provides our visitors with a broad selection of books related to this country's history with special emphasis on New England and its material culture. Reproductions of period fabrics and wallpapers in our collections have produced important royalties for the museum. Most of the sales on which royalties are earned are made through retailers in all parts of the country. While we serve a national audience, most of our visitors prefer to make their purchase near their homes where the fabrics and wallpapers can be coordinated with other furnishings.

The application of more rigid standards contained in the substitution of the words "directly related" for "substantially related" would inevitably reduce the museum's income from these sources with the result that our admission rates would have to be increased, thereby denying entry to a substantial audience unable to meet the increased gate fees. It is important for the members of the Committee to know that most nonprofit institutions today must show an operating statement in the black if they are to continue to serve the public in fulfillment of their mission statement. The loss of income represented in the proposal listed for consideration would have a profound effect on the ability of institutions, such as ours, to survive.

The important point to consider in examining this entire subject area is the absence of the for-profit arrangement which characterizes the nation's commercial and industrial communities. Indeed, the tax-exempt status we enjoy is predicated on the very real contribution this organization makes to the public good. There are no stockholders who benefit and it should be noted that our very presence in this community provides a considerable advantage to the profit sector that supplies food, lodging, and other retail services to our visitors. Sturbridge is a town with a population of approximately 7,500 people. Yet, within its borders, there are some 1,000 hotel/motel rooms, more than in the city of Worcester, New England's second largest city! The health of the retail sector is directly related to the health of this nonprofit museum and I know, firsthand, that our experience is no different from scores of comparable institutions across the country.

I would urge you to look in other directions for the additional tax revenue you may require. The nation's cultural organizations are basically fragile entities increasingly subject to forces over which they have no control. The very least the Congress can do is to take whatever action is necessary to stabilize and preserve the legitimate considerations which have long been a part of the nation's tax code and tax policy.

ONTARIO HEARING INSTRUMENTS CORP.
232-3080
TELEX HEARING AID CENTER

127 EAST AVE. ROCHESTER, N.Y. 14604 OHI CORP.

April 12, 1988

The Honorable J.J. Pickle
c/o Robert J. Leonard
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Re: UBIT Unrelated Business Income Tax

Dear Sir:

We want you to know that we appreciate and endorse your proposal for reform measures regarding non profit organizations dispensing Hearing Aids.

We would also like to encourage the Subcommittee to repeal the existing "convenience" exemption for inpatients.

We are commercial dispensors of Hearing Aids. We pay Federal, State and Local taxes on profits generated from our Retail sales.

In the past several years we have had more and more tax-exempt, not for profit organizations enter the dispensing field in direct competition to small business.

We consider these practices to be unfair because the "not for profit" organizations:

1. are subsidized by public, local and state funds
2. pay no Federal, Local or State taxes
3. are exempt from normal taxes as borne by most business such as sales tax, property tax, etc.
4. have no concern for excess overhead costs and as a result are generally below the normally accepted retail prices of products and services.

Specifically, we are concerned with the Al Sigl Hearing and Speech Center which has been subsidized in the amount of $180,000.00 by the United Way; and the Strong Memorial Hospital.

In the case of the latter, the Strong Memorial Hospital, Dr. Larry Dalzell, Chief of Audiology, under the guise of a non profit organization is referring patients for Hearing Aid Sales to Park East Hearing Center, 1641 East Avenue, which is operated by his wife, Shelia Dalzell.

We want to alert you to be aware of possible impending legislation to alleviate these problems and to be sympathetic to the small independent commercial businesses that make up the greatest part of the commercial activities of our country.

Sincerely,

Harold S. Meltzer
BC-HIS

OPELOUSAS GENERAL HOSPITAL
520 Prudhomme Lane
Opelousas, LA 70570
(318) 948-3011

April 12, 1988

The Honorable J. J. Pickle
Chairman
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Your Honor:

As Controller of Opelousas General Hospital, I have been asked to comment on the proposed changes to the Unrelated Business Income Tax (UBIT) rules. My comments and questions are as follows:

SUBSTANTIALLY RELATED TEST

1) Changes to the "Substantially Related" test refer to gift shop income exceptions as low-cost mementos. I fear this reference may be arbitrary and capricious. I would request further guidelines so as to avoid varying interpretations.

2) With regard to item B. - the exception for outpatient sales are for continuous-care outpatients. This, by definition, excludes same-day surgery patients and other "clinic" type patients. We need to change the wording or expand the definition to include outpatient surgeries or other prescribed physician referral services.

3) The above section also excludes sales to employees. As this is a common benefit in many health care facilities and not uncommon in most other industries, I feel we should require some exception for employee sales at reasonable prices.

4) Section H. seeks to apply UBIT to routine testing income with the exception of pre-surgical medical testing. Not all hospitalizations require surgery. This section does not specifically allow an exception for medically necessary non-pre-surgical medical testing. THIS SECTION HAS THE GREATEST POTENTIAL FOR HARM IF ADOPTED WITH THE CURRENT WORDING. For example, a head injury is admitted for 24 hour observation and an X-ray is performed. Given this ruling, the X-ray would be subject to taxation.

CONVENIENCE EXCEPTION

5) Relative to number 3), above, I feel that as it is a generally accepted practice in all industries to be allowed to sell to one's own employees, the repeal of the convenience exception would penalize hospital employees, non-surgical patients, officers, etc.

I appreciate the opportunity to voice my concerns regarding these proposed changes. If I can be of further assistance, please let me know.

Sincerely,

Terry L. Stofferson
Controller

STATEMENT TO THE OVERSIGHT SUBCOMMITTEE OF THE HOUSE OF REPRESENTATIVES WAYS AND MEANS COMMITTEE

Submitted by Martin I. Kagan, Executive Director of
OPERA America on April 15, 1988

This statement is submitted on behalf of over 100 professional non-profit opera companies throughout the United States regarding the preliminary discussion options for unrelated business income tax (UBIT) proposed by the Oversight Committee of the House Ways and Means Committee.

As you may be aware, there are no commercial, for-profit professional opera companies in the United States. Opera is an expensive art form to produce because it is very labor intensive. The income that is derived from the sale of tickets covers, on average, only 40% of the cost of producing the performances. The remaining income is received from government grants, private, corporate and foundation donations and other activities. All income is used solely to further the artistic and educational mission of the opera institution. Your proposed discussion options, if enacted, would have a devastating effect on the survival of these most important cultural institutions.

The following briefly summarizes our concerns:

1. The proposal to apply UBIT to income from all mail/phone orders or other "off-premise" sales would undermine the whole process by which subscriptions and tickets to opera performances are sold and distributed. Direct mail and phone ordering services have proven to be the most cost-effective sales tools and have had an enormous impact on box office sales. Since the majority of opera's earned revenue is from the sale of tickets, any tax on these methods of ticket sales would be severely crippling. The cost of the tax imposed or of alternative methods of selling tickets would dramatically increase the costs of survival and would make ticket prices prohibitively high for most people and lead to the demise of professional opera institutions.

2. Opera companies produce magazines and programs primarily as educational material for their audiences and, as such, these publications relate directly to the non-profit mission of a company. Therefore, it is unfair to apply UBIT to any advertising income. Such publications are dependent upon advertising revenue to defray the cost of producing them. Any surplus of revenue over expenses is used to further the artistic purposes of the institution.

3. Raising money to fulfill the non-profit goals of an opera company is very difficult. In addition to generating ticket sales, public grants and private donations, opera companies organize fundraising events, auctions, benefit performances, etc. These activities serve as a means of educating the public, promoting the art form and bringing visibility to opera companies while raising revenue to help meet operating expenses. They also involve countless individuals as volunteers and participants, in supporting professional opera companies in their communities. Repealing the "regularly carried on" requirement would tax these activities, thereby reducing their effectiveness in the important roles they serve.

4. To tax gift shop and bookstore items "of an educational nature which relate to the organizations visited" creates a significant problem for opera companies. Many of the items sold in person or by mail/phone are designed to increase the purchasers' awareness and knowledge of the art form, prior to their visit to the institution. They are offered as a service to the audience. For example, it is very informative for a person to listen to a recording and read the libretto and synopsis of an opera prior to attending the performance. To tax gift shop and bookstore sales undermines the ability of performing arts institutions to provide these services.

5. The exchange of mailing lists between non-profit arts institutions is a valuable way to increase audiences and better educate the public. It also demonstrates the belief that non-profit organizations need to work together in partnerships to enhance the life of the community. In addition, it is never perceived as an income activity and should not be subject to UBIT as such.

OPERADELAWARE

P.O. Box 3553
Greenville, Delaware 19807
(302) 658-2507

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing in response to your request for comments on the preliminary discussion options regarding unrelated business income tax (UBIT) released by the Subcommittee on Oversight, Committee on Ways and Means. As President of a nationally recognized (NEA supported) regional opera company, I would like to express my concern that several of the proposed options could materially impair our modest--but nevertheless crucial--programs to (1) hold down the costs of opera (especially ticket prices!) and (2) minimize our need for federal and state tax dollars to subsidize the unavoidable operating deficits associated with every major professional opera company in the world.

Initially, one might challenge the desirability of those goals; i.e., why not require opera to operate on a full "market" basis?

I could willingly expound at length on the question; however, I offer only the propositions that (1) opera is unique art form that has survived and thrived for approximately 400 years because it combines drama, music, voice, dance and history in a compelling matrix unique in the arts; and (2) that being true, it justifies certain reasonable state support in order to make it available to the broadest interested audiences--especially the elderly, the young and the historically disadvantaged (who make up large percentages of potential urban audience growth).

Accepting that premise and addressing our immediate concerns, OperaDelaware believes it is in a credible position to offer accurate and objective comments: we are the 13th oldest opera company in the U.S., and as mentioned, are nationally recognized. Yet, we produce major opera programs for approximately one-half the cost of equivalent companies. We do this through the support of hundreds of dedicated and talented volunteers; our full-time paid staff consists of two persons! In short, we are financially extremely conservative, operating on very tight budgets; therefore, adverse changes in the tax laws can have serious impact on our operations. And, I think it fair to add that this could be doubly true in times when the federal government is seeking to minimize its outlays to the arts and pass more of the support burden to state legislatures. (Delaware legislators have already agreed to a support level per/capita that is the 17th highest in the country.)

Specifically, I draw your attention to the following:

1. Proposed taxation of program advertising would eliminate the opportunity for arts organizations to obtain business community (often small business) support for program expense; these costs are considerable and their absorption by (e.g.) our opera company would require increased ticket prices. We, as most opera companies, have approached the limit of such increases, especially if we are to succeed in audience development--a key goal as mentioned. On the other hand, local merchants now find the cost of supporting program publications as reasonable considering the audiences reached. Thus such an option will increase our costs and reduce opportunities for small businesses to expand their recognition as merchants and supporters of the arts.

2. The taxation of mailing list exchanges or rentals can but reduce efforts to increase audiences; computers now make it possible for varying organizations to share data on potential subscribers and contributors, both of which once contacted may provide theretofore unavailable support. To discourage these activities is to subvert an essential new and useful tool of communication.

3. The taxation of "profits" from the sale of low-cost items (such as T-shirts) "used in contribution drives" raises several difficulties: Firstly, such items are more for publicity and image-enhancement than for revenue; generally the "profit" provides little above the cost of manufacture and distribution (in actuality, these items are low-budget advertising). To tax--and thereby either increase cost or eliminate the activity--runs the risk of destroying a popular low-cost method of reaching many arts supporters that cannot afford large donations but want to participate and receive some modest object in evidence of their support. Secondly, (while some consider this argument counterproductive, I disagree!) the administrative cost and difficulty of identifying and reporting the many small transactions--handled primarily by volunteers--would be a serious disadvantage for (e.g.) a company such as ours with two paid staff; and, to discourage our volunteers through unpopular paperwork is to destroy organizations such as OperaDelaware!

4. To alter the tax procedures relating to "income" received by opera companies for rental of their sets and costumes would be another blow to opera companies such as ours: OperaDelaware volunteers construct our sets; our average cost is under $10,000 as compared with equivalent commercial construction costs of $30,000. But, even that $10,000 is a high percentage of an entire production; therefore, at a considerably lesser expense, we have where appropriate rented sets constructed by other companies having similar facilities, and we likewise rent our sets whenever possible to our sister companies. Thus we minimize production costs in a wide-spread manner that benefits the opera community as a whole...and audiences in general.

5. While all of the above threaten our expense control efforts, the most serious option proposed in our context is taxation of revenue from (e.g.) many annual fund-raising activities accomplished by opera and opera guild organizations. The ability to hold balls, dinners, benefit concerts, designer showcases and similar events assures the viability of the major non-governmental funding source outside ticket sales...which account for less than one-half operating costs (and this is a "successful" opera company!). To tax the results of the labor of hundreds of dedicated unpaid fund-raisers is to unquestionably reduce their number and dedication. (If a revised tax-system were to permit us to deduct the value of their labor as a cost-of-goods sold, I would have little problem with taxation...there would never be a "profit!") And when fund-raising is accomplished by volunteers who must have flexible schedules and commitments, to propose a limit of (e.g.) one tax-free fund raising function a year--is to materially limit the often opportunistic events available to cover operating expenses. (I would not even know how to identify the "one" activity not to be taxed?)

Such are the gravest of our concerns and, frankly, OperaDelaware will be materially injured if they were all to be enacted.

As to positive offerings: we do not believe arts organizations should be untaxed where obvious "commercialization" occurs in areas not directly in support of their artistic activities. And, if there are some large organizations that appear to abuse their freedoms, we would favor rational changes to prevent future abuses. However, if in curtailing such abuses you endanger the fundamental structure under which most of our arts organizations are able to raise the additional financial support they need to survive...and hopefully grow...you will do a great deal more harm than throwing the baby out with its bath water.

And, for those who might find that caution should not be practiced notwithstanding the historic, intellectual, cultural and educational role played by the arts in America, before they approve severe tax constraints on our fund raising efforts they should consider the following conclusion documented in a recent Delaware State Arts Council sponsored study:

> "The arts are an important economic force in Delaware, directly employing 1,659 persons...and generating over 4,324 jobs, $37.1 million in wages and $116.8 million in output; serving clientele of over 755,000; leveraging more than $19 of operating revenue for every dollar of public seed money."

We suggest this is true throughout our country; if so, they should be nourished, not threatened. Many of the released tax options do just that! They should not be approved.

Respectfully yours,

President

cc: Members Subcommittee on Oversight
Senator William V. Roth, Jr.
Senator Joseph R. Biden, Jr.
Congressman Thomas R. Carper

PACIFIC LINEN SERVICE

MAR 30 1988

March 25, 1988

Congressman J. J. Pickle
U. S. House of Representatives
Washington, D. C. 20515

Congressman Pickle,

I strongly believe that the tax treatment of non-profits needs to be reformed.

As a linen service competing in our free enterprise system, we find that we are in direct competition with non-profit hospitals offering linen service at reduced rates, because of their favored position.

Sincerely,

Joseph H. O'Grady

Quality Processors of Linen
720 South Pacific • Oxnard, CA 93030
(805) 486-4861 • (800) 445-7332

1799 · 1867

Peabody Museum
Founded by the East India Marine Society 1799
East India Square
Salem, Massachusetts 01970

April 14, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight,
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington DC 20515

Dear Chairman Pickle:

With regard to the Subcommittee's deliberations on the issue of taxation of non-profits' revenue-producing activities, we believe your recommendations are extremely important and will have far-reaching consequences for the country's important cultural institutions; for this reason we urge you to deliberate with especial care.

We speak for the Peabody Museum of Salem, a museum founded in 1799 by a farsighted group of seafaring captains. The Museum has operated continuously since that time and houses a collection of over 300,000 artifacts which tell the story of an important aspect of our nation's growth and development.

We serve close to 100,000 people annually, adults and school children alike. Admissions and program fees provide only 8% of our income. The remainder comes from gifts and membership dues from supporters, supplemented by earned revenues. Earned revenues constitute about 12% of our approximately $2,000,000 in operating revenues.

Federal funding sources on the other hand, via grants from the Institute of Museum Services and the National Endowments, while also very important to us, constitute about 3% of our total funding sources.

Cultural institutions are part of our national treasure; they need and deserve governmental support. If the Congress votes to extend taxation of these institutions, they will, in effect, cut into this relatively modest existing federal support. Most cultural institutions in this country do not enjoy generous governmental subsidies; they constantly struggle to remain alive. If this burden is increased, some will surely fail and the country will be poorer for it.

Please deliberate carefully.

Sincerely,
Peter Fetchko
Peter Fetchko
Director

Anne Wood Lipner
Anne Wood Lipner
Associate Director

TELEPHONE (617) 745-1876

PENNIMAN
& BROWNE,
INC.
CHEMISTS / ENGINEERS / INSPECTORS

6252 FALLS ROAD / BALTIMORE, MARYLAND 21209 / TELEPHONE: 301-825-4131 / TELEX II: 710-234-1641

April 7, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I am writing to express support for reform of UBIT in response to your request for public comment by April 15.

Penniman & Browne, Inc. is a small independent commercial testing laboratory. We employ approximately 25 people and bill annually in excess of $1 million. We compete with various agencies of the state and federal governments, dozens of other independent laboratories in our Baltimore-Washington metropolitan market area, and an increasing number of non-profit institutions. It is competition from this third source which is the concern which prompts this letter.

It is of concern because it is hurting us: we have lost business to non-profits. It is of concern because it is unfair competition: non-profits receive a subsidy from the United States Government. It is of concern to us because it is correctable: your committee can correct one of the worst abuses by eliminating the exemption for "testing for the public safety" from the UBIT.

Penniman & Browne, Inc. tests for the public safety when we inspect bridges and construction materials, analyze lead in paint or chemicals in wastewater, or test welds and metals. Yet we pay taxes, and so do the other commercial laboratories with which we compete. Non-profits should not be permitted to abuse this tax exemption, and the best way to prevent this abuse is to eliminate this exemption.

Thank you for inviting our comments. We would be happy to meet with you or members of the Ways and Means Committee to expand on them if you would like.

Sincerely

Herbert E. Wilgis, Jr., President

HEW/bw

Pennsylvania Veterinary Medical Association

Palace H. Seitz, V.M.D.
Secretary-Treasurer
P.O. Box 403
Harrisburg, Pa. 17108
717-233-7720

April 12, 1988

The Hon. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Leonard:

The more than 1300 members of the Pennsylvania Veterinary Medical Association strongly endorse the excellent package of reform measures to the unrelated business income tax (UBIT) proposed by the Oversight Subcommittee of the House Committee on Ways and Means. We commend Chairman Pickle and Representative Schulze, as well as the entire committee, for their thoughtful consideration of a difficult problem.

We encourage the subcommittee to include its proposed measures in its final report.

Unfair competition by non-profit organizations is a serious problem affecting the private practice of veterinary medicine. There are numerous tax-exempt groups which are taking advantage of their tax-free status to unfairly compete with private veterinarians by undercutting prices. They are able to do so because they do not have to pay the taxes that must be paid by the private practitioner.

We believe it proper to provide tax exemptions for purely public charities because they benefit the public. However, the tax-exempt status of a charity should not be extended to benefit an activity which is not itself charitable -- i.e., a humane society chartered to receive and dispose of unwanted or stray animals which also provides full veterinary services to pet owners in competition with the services of private veterinarians. The unfairness can occur directly, by a tax-exempt organization engaging in an overtly commercial activity such as just mentioned, or indirectly, by a tax-exempt organization subsidizing the commercial activities of another commercial organization.

At a time when economic concerns are paramount, it is essential to reexamine our need for a strong and healthy tax-paying private sector. The laudable goals of non-profits, such as pursuing education, research and charitable activities, do not justify an unexamined, uncontrolled growth of commercial activities by nonprofit entities.

Sincerely,

PENNSYLVANIA VETERINARY MEDICAL ASSOCIATION

Kenton S Stokes

Kenton S. Stokes, V.M.D.
President

KSS:nt

cc: Rep. R. Schulze, Rep. B. Anthony, Rep. B. Dorgan, Rep. H. Ford, Rep. R. Flippo, Rep. B. Frenzel, Rep. A. Jacobs, Rep. R. McGrath, Rep. C. Rangel, Rep. W. Thomas

PHILADELPHIA
MUSEUM
OF ART

Benjamin Franklin Parkway, Box 7646, Philadelphia, Pennsylvania 19101-7646 · Telephone: 215 763-8100 · Cable: Philmuse

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

This letter responds to the invitation by the U.S. House of Representatives' Ways and Means Oversight Committee for submission of public comment on the discussion options relating to the Unrelated Business Income Tax Bill. The Philadelphia Museum of Art joins others in this country's cultural community in urging that Congress maintain the UBIT Bill as it currently stands, and in expressing concern about the negative impact the proposed options will have upon the Museum's earned income -- particularly through our Museum Shop -- and on our mission as an educational institution.

Housing some 300,000 objects of art spanning 2000 years of world cultures, the Philadelphia Museum of Art specializes in the art of Europe, America and the Far East. In our more than 100-year history, we have enjoyed the support of millions of visitors -- over 600,000 last fiscal year -- coming from the City of Philadelphia, the region, and abroad and from the widest public: young children to older adults, new cultural consumers to scholars, all ethnic groups, and the disabled. Through a lively array of regular programs and services, offered at no or low cost, the Museum seeks to enhance visitors' understanding and enjoyment of art and the creative process.

The Museum relies on several income-producing efforts to help meet the enormous annual expense of preserving our collections, maintaining and operating our facility, and serving this enthusiastic and growing audience. Aside from contributions continually sought from public and private sources, and admission fees, we also look to our Museum Shop to generate much-needed income. Consistent with the Museum's philosophy to engage and educate our public, the Shop makes available the highest quality books, postcards and other gifts for purchase.

As currently proposed under the "Discussion Options" for changing the existing Unrelated Business Income Tax, while the Law would not apply to the sale of low-cost mementos in the Shop such as a paperweight, it would appear to apply to a considerable number of art books (books comprise a major percentage of Museum Shop offerings) which could not, by the "Discussion Options"' definition, pass the test as "substantially related" to the Museum's exempt purposes because such publications discuss or feature works of art outside of the Museum's holdings or special exhibitions and would, therefore, be construed as "inherently commercial."

The above example dramatizes how application of the UBIT would significantly narrow the Museum's and, by extension, the Museum Shop's educational goals. We believe that as a museum we have an obligation to teach our public about world cultures and the diverse forms of their creativity. It is critical that our visitors learn about the interplay and interdependence of the arts upon themselves as well as of the arts to the everyday lives of humankind. The books carried by the Museum Shop give the public the opportunity to take with them this information which can contribute so significantly to their knowledge.

Do not remove the Museum's ability to teach people about themselves and others and to learn about and participate in art through the purchase of publications and other art-related goods. Do not take away one of the Museum's principal means to carry out this central, educational goal while also reducing the income which makes possible such important activities and services.

The Philadelphia Museum of Art supports maintaining the current Unrelated Business Income Tax law without changes; the law's treatment of museums' income-producing activities and its "substantially-related" test works and is appropriate, in our view.

We welcome the opportunity to contribute to the House of Representative's thinking on the UBIT law and hope that you will give favorable consideration to our opinion.

Sincerely,

Cheryl McClenney-Brooker

Cheryl McClenney-Brooker
Vice President for
External Affairs

PIERPONT
RACQUET CLUB

April 15, 1988

Oversight Committee of House Ways & Means
House of Representatives
Washington, D.C.

Dear Sirs,

Last year I had the privilege of testifying before you on the issue of tax exempt competition. At that time, I expressed my concerns that nonprofit entities such as the YMCA had unfair advantages over private businessmen such as myself, and that the public as a whole does not benefit. Leaving the hearings, I was relieved because it was my feeling that action would be taken that would prevent nonprofits from competing unfairly against private operators.

Unfortunately, it appears my relief was premature. As I understand it, your proposal regarding UBIT will not provide relief from unfair competition. I sincerely hope that you will amend your recommendations to ensure that nonprofit entities such as the YMCA do not have advantages over private businesses when offering like services to citizens who can afford to pay market rates.

Organizations such as the YMCA continue to build and operate fitness and recreation facilities in direct competition with private businesses. They advertise to attract the very same individuals that would join a club such as my own, and they operate their facilities in much the same manner. Given the fact that they pay no property taxes and can even raise funds for capital expansion with tax deductible contributions, they are a formidable competitor. They can, by virtue of such advantages, afford to charge lesser fees (although, in fact, many private operators offer services at the same or lesser rates).

If the intent of the legislature is to provide health and recreation services to our citizens at lower rates, this can be accomplished by offering tax exempt status to all health and recreation providers. Why should only nonprofits such as the YMCA be afforded tax exempt status? If health and recreation activities and services are charitable in nature, all who provide them should receive tax exemption. That not being the case, I urge you to ensure that your findings for the health and recreation industry are more fair than they now appear.

Your proposal to allow nonprofit entities to be excluded from UBIT if the service they provide is affordable to the community is not a deterring factor. Private operators provide service at affordable rates by necessity. The free market dictates it. If it's not affordable to the community, the private operator would not be in business for long. Given that and nonprofits' lower operating costs by virtue of their tax exemption, it stands to reason that they should always be affordable.

next page please

Further, your wording would allow nonprofits such as the YMCA to build elaborate facilities in upscale markets. Such facilities would be affordable to that community they are in, but would they be serving a charitable need? Please make sure that your wording meets your intent. Hopefully the intent is to ensure that nonprofits providing services to the disadvantaged are rewarded by receiving tax exemption. When nonprofits benefit from providing services to members, the majority of which are not underprivileged, something is wrong.

I believe that any wording should reflect that UBIT would be waived if the citizens receiving the service deserved help, not if the services are affordable. Why reward nonprofits for providing service to citizens who could just as easily be paying for that service from taxing paying private operators? As it stands, your recommendation would allow a nonprofit to operate a posh club in a glitzy community serving high paid professionals, while paying no taxes. And that is what YMCAs are doing. It does not encourage them to operate only in areas that can't afford services. In fact, YMCAs are closing many such facilities because "they don't pay."

How can you test the effectiveness of your current proposal? Take a look at the Stuart Ketchum YMCA in downtown Los Angeles. It is affordable to the community it serves, namely the professionals and office workers in the area. Many of its members were previously members of private clubs in the area. Your definition would allow it to be tax exempt even though few if any children are being served. Is that right? I hope that you agree something is wrong and that you will work to correct that inequity.

What is my suggestion? *"Apply UBIT to all income generated from health, fitness and recreation activities and facilities except for income generated from charitable classed individuals."* Wording to such effect would reward nonprofits for serving the underprivileged. Don't reward them for providing services to those who could just as well get it from private tax paying operators.

Thank you for your attention to this very important matter. Should you have any questions, I would be happy to address them

Respectfully submitted,

Spencer Garrett

Spencer Garrett
General Partner
Pierpont Racquet Club
500 Sanjon Road
Ventura, CA 93001
(805) 648-5161

PIKES PEAK HEARING AID CENTER
FRANK A. KROEZE, CERTIFIED HEARING AID AUDIOLOGIST
P. O. BOX 98 21 EAST BIJOU COLORADO SPRINGS, COLORADO 80903 PHONE 633-4693

April 12, 1983

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

Your efforts in behalf of small business and the subcommittees UBIT recommendations are excellent and will be effective. Your package of reform measures will help protect our interests. All of the measures must be included in your final report. As a hearing aid dispenser I urge you to apply UBIT to all hearing aid sales of non-profits. When they do not pay it causes an unfair business practice.

I also recommend repealing the present "convenience" exemption for patients or recognize patients as "inpatients".

In our community we have the University of Colorado and many hospitals operating under the protection of non profit organizations.

I am in full support of your recommendations.

Sincerely,

Frank A. Kroeze, President
Pikes Peak Hearing Aid Center

FK/ph

POETS & WRITERS

April 12, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to express my opinion on the options now being discussed by the House Ways and Means Subcommittee on Oversight regarding income-producing activities of nonprofit organizations.

Our organization, which serves poets and fiction writers across the country, has successfully built our earned income base over the past eight years. In part this was in response to reductions in our grant from the National Endowment for the Arts. We, along with other arts organizations, were encouraged to develop alternate forms of revenue as support from the Federal government diminished. For the government to impose taxes on the very income we were urged to develop seems unfair, and I urge the subcommitee to consider the damage which would be done to many nonprofit organizations which provide valuable services to our citizens, services which the government has already cut back on, and may need to cut back on further in the years ahead.

For Poets & Writers, taxes on the advertising and subscription income generated through sales of our magazine and taxes on mailing list rentals would be particularly harmful. Our viability as an organization very much depends on the revenue we earn. Along with the grants we receive from government agencies and the money we raise from private sources, this income makes it possible for us to help a vital national resource, our poets and fiction writers, who in turn produce our literature.

Sincerely,

Elliot Figman
Executive Director

201 WEST 54 STREET NEW YORK NY 10019 212-757-1766

Board of Directors: Galen Williams, *Founding Chairman* Timothy Seldes, *President* Lynne Alvarez, *Vice President* Ellen Joseph, *Secretary* Robin Smith, *Treasurer* Richard Abrons Donald Everett Axinn Mary Sharp Cronson E.L. Doctorow Nancy Evans Helen Handley John W. Holman, Jr. Beverly Jablons Jeremiah Kaplan Galway Kinnell Wendy Wilder Larsen Audre Lorde John Marvin Honor Moore Joanna S. Rose Perdita Schaffner Gail Sheehy *Executive Director:* Elliot Figman

PORTLAND SYMPHONY ORCHESTRA
30 MYRTLE STREET PORTLAND, MAINE 04101 207/773-6128

April 13, 1988

The Honorable J.J. PIckle (D. Texas)
Chairman, Subcommittee on Oversight,
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

My Dear Mr. Pickle:

I recently received a copy of Press Release #16 and wish to respond to your request for public comment on the discussion options relating to the Unrelated Business Income Tax.

After a first reading of the material in Press Release #16, one cannot help but notice the broad scope of non-profit organizations that would be affected by any change in existing legislation. Obviously, unrelated business income and the manner in which it is generated is as diverse as the organizations in question. As a manager of a Regional Symphony Orchestra, my comments may well be pertinent to only arts organizations, and orchestras or performing arts groups in particular.

Having acknowledged these varying circumstances, I will begin by saying that implementation of some of the discussion items would unfairly burden the Portland Symphony to the point where it would have to make major programming cutbacks. As it enters its 65th year of existence, the Portland Symphony is the largest musical organization and one of the three largest arts organizations in the State of Maine. It employs 83 professional musicians on a per service basis and 11 staff members on a full time basis. 65.1% of the orchestra's $1.5 million budget is earned income generated principally by ticket sales. Only 3.4% of our income is derived from state or federal sources, while an additional 23% comes from contributions from individuals, corporations, and the Portland Symphony auxiliary, the Women's Committee.

With the resources mentioned above, the orchestra provides educational programs at a very nominal cost for more than 50,000 students in the northern New England area. Its year-round programming provides live orchestral performances for more than 80,000 citizens. Ticket sales for these events usually occur off site. The proposed tax on off premeise sales, we feel, could conceivably encompass telephone and mail order sales. We certainly hope that is not the subcommittee's intention and that any

TOSHIYUKI SHIMADA
MUSIC DIRECTOR AND CONDUCTOR

JANE E. HUNTER
GENERAL MANAGER

proposal would make this point clear.

Revenues from advertising sales barely cover the cost of printing and distributing the program booklets. Printed programs are necessary for educational and contractural purposes. The booklets contain program notes which inform the audience about the works being performed and provide the obligatory naming and recognition of orchestral and guest artists and concert sponsors. Additionally, the organization is committed to using the program books to communicate important information to the audience regarding emergency exit identification and procedures. Imposition of a tax on the revenues that make printing of the program book possible wuld require allocation of operating funds which in turn, necessitate increased ticket prices. Since many of our subscribers are senior citizens on fixed incomes, we feel this would place a considerable hardship on our audience members.

Additionally, the proposed taxing of fees charged for mailing lists or rentals would necessitate implementation of costly and cumbersome bookkeeping procedures that would put an end to the orchestra's ability to help its fellow arts organizations produce occasional programs that require use of symphony instruments or equipment.

Over the years, hundreds of people have donated literally thousands of hours and tens of thousands of dollars to provide the community with an important cultural institution. The orchestra and other arts organizations that would be affected by these proposals have made important contributions to the quality of life of the Portland area and its prosperity. Taxing legitimate activities that provide some convenience and/or assistance in meeting the financial needs of the orchestra is unproductive.

We hope the members of the subcommittee will recognize the community's committment to the arts and help to keep what amount to economic roadblocks out of the way. I urge you and the subcommittee not to recommend the creation of these new taxes. Thank you for your consideration.

Cordially,

Jane E. Hunter
General Manager

cc: Senator George Mitchell
Senator William Cohen
Rep. Olympia Snowe
Rep. Joseph Brennan
American Arts Alliance

THE ART MUSEUM PRINCETON UNIVERSITY PRINCETON, NEW JERSEY 08544 TELEPHONE (609) 452 - 3788

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chief Counsel Leonard:

We are very concerned that the House Ways and Means Subcommittee on Oversight is considering the imposition of Unrelated Business Income Tax on income from gift shop sales, off-premises sales (catalogues, mail and phone orders), royalty income, travel and tour services, mail list exchanges or rentals, and low-cost items such as tee-shirts used in contribution drives.

As the funding sources available to cultural institutions dwindle, self-generated income becomes increasingly important. Without the ability to generate income, cultural institutions will be forced to lay off staff and curtail services to the public.

We urge you to reconsider and to leave the UBIT as it now stands.

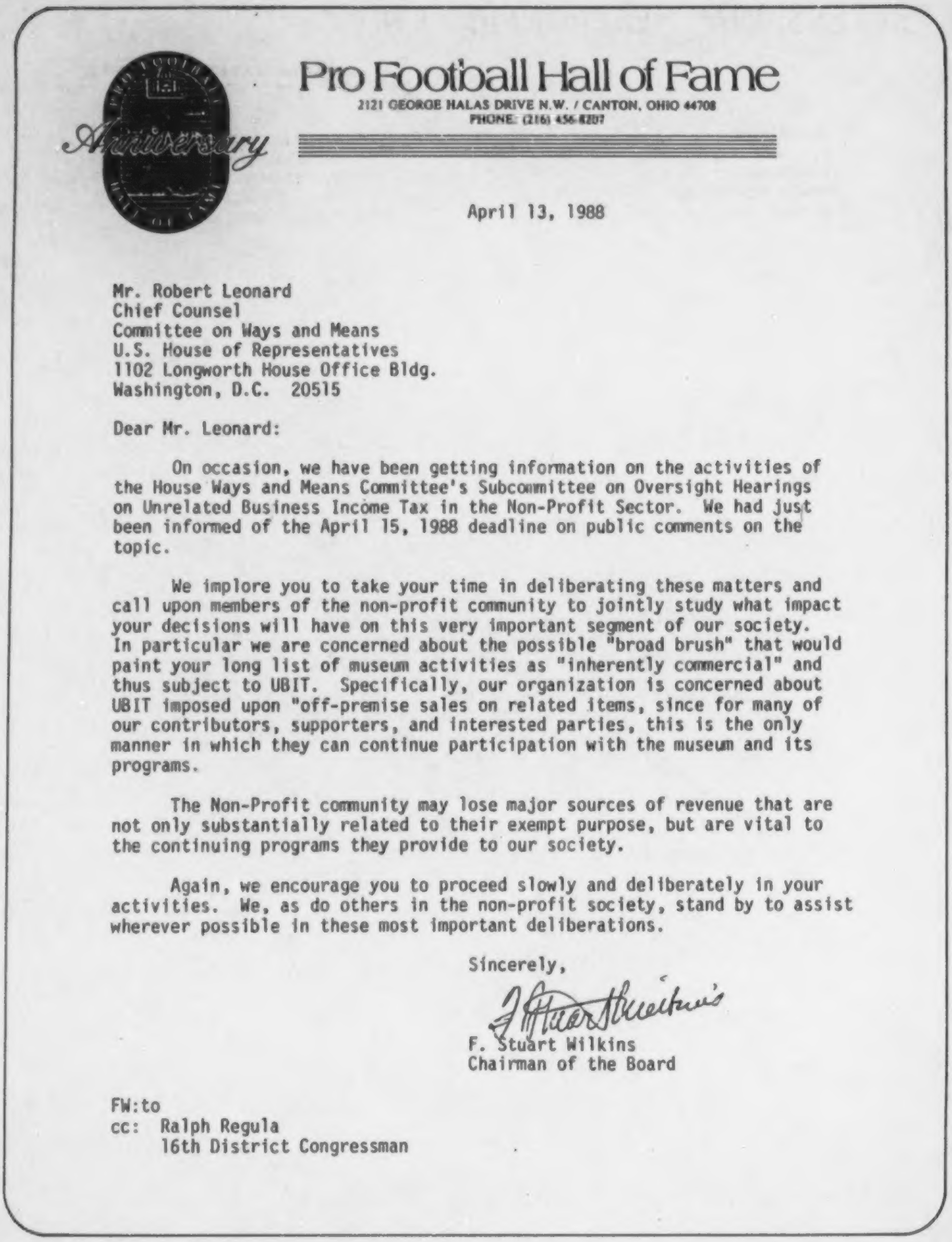
Sincerely yours,

Charles K Steiner

Charles K. Steiner
Assistant Director

CKS/jm

cc: Oversight Committee:
J.J. Pickle
Charles Rangel
Andrew Jacobs
Harold Ford
Beryl Anthony
Ronnie Flippo
Byron Dorgan
Richard Schulze
Bill Frenzel
William Thomas
Raymond McGrath



Pro Football Hall of Fame
2121 GEORGE HALAS DRIVE N.W. / CANTON, OHIO 44708
PHONE: (216) 456-8207

April 13, 1988

Mr. Robert Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

On occasion, we have been getting information on the activities of the House Ways and Means Committee's Subcommittee on Oversight Hearings on Unrelated Business Income Tax in the Non-Profit Sector. We had just been informed of the April 15, 1988 deadline on public comments on the topic.

We implore you to take your time in deliberating these matters and call upon members of the non-profit community to jointly study what impact your decisions will have on this very important segment of our society. In particular we are concerned about the possible "broad brush" that would paint your long list of museum activities as "inherently commercial" and thus subject to UBIT. Specifically, our organization is concerned about UBIT imposed upon "off-premise sales on related items, since for many of our contributors, supporters, and interested parties, this is the only manner in which they can continue participation with the museum and its programs.

The Non-Profit community may lose major sources of revenue that are not only substantially related to their exempt purpose, but are vital to the continuing programs they provide to our society.

Again, we encourage you to proceed slowly and deliberately in your activities. We, as do others in the non-profit society, stand by to assist wherever possible in these most important deliberations.

Sincerely,

F. Stuart Wilkins
Chairman of the Board

FW:to
cc: Ralph Regula
16th District Congressman

(Identical letters were received from William Belden, Treasurer, Clayton G. Horn, Vice President, and John Muhlbach, Secretary.)

PROFESSIONAL HEARING AIDS SERVICE

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2204 FLATBUSH Avenue
Corner Avenue R
BROOKLYN, N.Y. 11234
Phones: 253-0557-0558
MARK ZELNICK, M.S.

April 12, 1988

Honorable J.J. Pickle
Chairman of House Ways and
Means OversightSubcommittee
Washington, D.C. 20515

Honorable Sir:

I am a Hearing Aid Dispensing Audiologist and have been involved in the sale and service of hearing aids for over thirty-five years in Brooklyn New York.

My company has two offices and employs twelve people. In the last few years, tax exempt organizations such as hospitals, colleges and speech and hearing centers have begun to dispense hearing aids.

Naturally as a tax-exempt institution many of them receive contributions from the public and grants from goverment agencies and are able to undersell my office. Although I feel the service that we render to the Hearing-Impaired public is superior, it is still a problem coping with such unfair competition. Perhaps if I was granted tax exemption and given grants, I could compete on an equal basis with them.

I feel the feasible way to handle this situation is to either cancel their tax exemption status or have them decease the practice of hearing aid dispensing.

If any further information is desired, I will be more than happy to cooperate with your committee.

Cordially yours,

Ernest Zelnick Ph.D.

Ernest Zelnick, Ph.D.

ez:hh

PURDUE UNIVERSITY

STEVEN C. BEERING
PRESIDENT

12 April 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

In response to the Subcommittee on Oversight's request for public comments on discussion options relating to the Unrelated Business Income Tax (UBIT) as outlined in Press Release No. 16, dated 31 March 1988, I offer the following comments:

1. Repeal of the "substantially related" test and replacing it with a "directly related" or "stand alone" test is significantly more restrictive and does not appear to be within the spirit of the original exemption which recognized that the functions of a major research university include a wide spectrum of activities necessary to carry out our instruction, research, and public service missions. If any of these activities are not "substantially related" to our primary functions, they should be taxed.

2. Applying UBIT to routine testing activities without exceptions for federal- or state-mandated programs, student educational programs, or research testing activities again ignores the broad spectrum of university activities.

3. Exposing royalty income of a college or university to UBIT could have a serious negative impact on transferring technology developed in the laboratories of colleges and universities to the public sector. The interests served by excluding such income are not only higher education but substantial national interests as reflected by the many state and national governmental policies which have been enacted to encourage such transfers.

WEST LAFAYETTE, INDIANA 47907 • 317-494-9708

4. The allocation rules as outlined in item VIII. of the News Release suggest that we would not be permitted to recognize overhead or depreciation expenses for those facilities used for both exempt and unrelated purposes. These rules appear to be contrary to all generally accepted accounting and costing procedures. The suggestion that overhead and depreciation expenses of a college or university are not real, imposes a severe penalty contrary to what has been a long accepted accounting and costing principle throughout the business world.

The very tight time frame between receiving the Subcommittee document and response due date does not permit a more detailed response at this point. However, it must be considered that American colleges and universities play a key role in maintaining the United States' leadership role in international competition in science and technology.

Recent legislation enacted by Congress has impeded our ability to attract U.S.-born graduate students by taxing fellowships and graduate fee remissions. Further taxation of college and university activities will impede our ability to carry out our research and instruction activities which are so important to the continued success and leadership of the country.

If abuses of current tax laws are occurring within the higher education community, they should certainly be corrected. However, it would appear that most of those abuses could be corrected through enforcement of existing laws.

New laws will not generate significant additional revenue but will place additional legal and administrative burdens on colleges and universities, driving up our operating costs and again providing a disincentive to our ability to carry on the instruction and research activities so important to the nation.

We very much appreciate the opportunity to provide input into these very important deliberations. While this response is by necessity brief, members of my staff and I would be most happy to provide additional information or elaboration of these or other areas of consideration.

Very truly yours,

Steven C. Beering

Steven C. Beering
President

PUTNAM
MUSEUM
Quad Cities USA

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

RE: Discussion Options Concering to Unrelated Business Income Tax

Dear Mr. Leonard:

The Putnam Museum, a regional museum of history, natural science and anthropology, is a 401(c)(3) organization established in 1867. It serves a population of 750,000 people in eastern Iowa and western Illinois.

The Museum's current year budget stands at $763,385 of which only 2% comes from governmental sources (and that being a grant from the Institute of Museum Services). The remainder of the funds which enable us to provide educational and cultural services for 190,000 people a year are derived from endowments, community fundraising -- both corporate and individual, -- and revenues the Museum earns through admission fees, membership dues, education program fees, and receipts from our Museum Shop. That shop operation will net $47,000 in this year, 6.2% of our total revenue.

The Committee is currently addressing a number of questions and issues concerning the taxability of those museum shop receipts. We have concerns in three areas. First, the possibility that taxes would be levied on those receipts. The Putnam's shop offers articles only substantially-related to its collections and exhibits. While it sells souvenirs, the shop provides the Quad Cities' only source of a wide variety of books, games and other educational materials related to our areas of scholarship. While the Museum recognizes the appropriateness of concern over unrelated business activity, it is gravely concerned about the revenue source reduction that will occur if the shop receipts were subject to federal business taxes. This institution would have no choice but to turn back to the community, to the area's individuals and businesses to make up the lost revenue.

The second area of concern is the record keeping and processing requirements that would result from imposition of UBIT on selected gift shop receipts. This could be a major problem for a small, primarily volunteer-staffed shop like ours where the inventory is not computerized.

1717 West 12th Street, Davenport, Iowa 52804 (319) 324-1933

If UBIT were imposed on some but not on other inventory items, it would cost us an estimated 5 to 10% of gross sales each year simply to establish and maintain records for tax purposes.

The third area of concern lies in the matter of the national cultural policy. The Putnam is an accredited institution; its storage areas contain the cultural and scientific record of this region including such significant objects as an original of the United States government's 1832 treaty with Black Hawk's Sac Indians, specimens of plants which long ago disappeared, and much more. Putnam galleries contain educational exhibits; its programming enlivens the school curriculum and brings the area's heritage to youngsters and to people not so young.

The Museum pays sales and use taxes, FICA, charges to regulated utilities, motor fuel and other taxes. Yet it does not price its product (exhibits and educational programs) as business prices its products. It does that because the American public expects its museum learning opportunities to be offered at reasonable fees or even free. What, then, I ask, is the national policy? Shall museums capitalize and compete in the free market place? I think not; I believe that Americans truly value the sector in our society that stands alongside private enterprise and government. That sector is the not-for-profit sector and museums like the Putnam are very much a part of it.

It should be, I submit, national policy that the for-profit and governmental sectors encourage and support the not-for-profit museums and their role in the community. Applying UBIT or other taxes and attendant record keeping loads to organizations like the Putnam Museum would not be encouragement. It would simply throw the requirement for support back onto individuals and the local business community. At the community level, the need for museum dollars would still exist.

Thus, we urge the committee to consider the broadest national policy implications as well as the micro effect on an institution such as the Putnam Museum.

Thank you for this opportunity to comment.

Sincerely,

Michael J

Michael J. Smith
Director

MJS/mt

cc: The Honorable James A. Leach
The Honorable Lane Evans

QUIET VALLEY
LIVING HISTORICAL FARM
R. D. 2 BOX 2495
STROUDSBURG, PA. 18360
TELEPHONE 717-992-6161

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard,

I am writing on behalf of Historical Farm Association, a private non-profit organization. We are a small living history museum, operating under the trade name of Quiet Valley Living Historical Farm, which spends most of our time in educating the general public, mostly school children and families. We do not receive government funding or any outside contributions from corporations and foundations. Revenue from our gift shop is essential and an income tax on monies received from these goods would be a burden to our organization as we struggle to remain independent and self-supporting.

We urge you to oppose this legislation which would impose an unrelated business income tax for non-profits with this tax exempt status.

Sincerely yours,

Sue W. Oiler
Co-Manager
Quiet Valley Living
Historical Farm

quiet valley DIRECTIONS

FROM STROUDSBURG AND NEW JERSEY

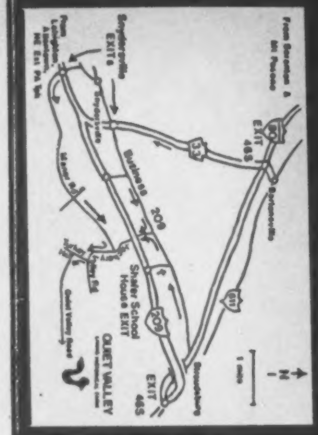
Rt. 80W exit 46S onto Rt. 209. Right at Shafer's School House Road. Follow signs (1½ miles).

FROM SCRANTON-WILKES BARRE AREA:

Rt. 380 to Rt. 80E to Rt. 33; use second Snydersville exit; follow signs (2½ miles)

FROM ALLENTOWN:

Rt. 22 East to Rt. 33. Use Snydersville exit; follow signs (2½ miles)



From Scranton & Mt Pocono
80
EXIT 46S
Bartonsville
611
1 mile
N
33
Stroudsburg
Business 209
209
EXIT 46S
Snydersville EXITs
Snydersville
Shafer School House EXIT
QUIET VALLEY
LIVING HISTORICAL FARM
From Lehighton, Allentown, NE Ext PA Tpk
Manor Rd
Valley Rd
Quiet Valley Road

Sue and Gary Oiler, Managers

BOX 2495, R.D. 2, STROUDSBURG, PA 18360

Phone: (717) 992-6161

CONTINUOUS TOURS

Weekdays 9:30 a.m. to 5:30 p.m.

Sundays 1:00 p.m. to 5:30 p.m.

(Last tour of the day at 4 p.m.)

Rain or Shine

Open June 20 to Labor Day

Tickets Sold at Admission Booth

Groups by appointment from May 1st to June 20th

Inquire about participating membership

5716/88

quiet valley

LIVING HISTORICAL FARM

Stroudsburg, PA

QUIET VALLEY LIVING HISTORICAL FARM

The farm is an example of humble Colonial life in an almost self-sufficient homestead. Costumed "family" guides share with you the daily routine of a thrifty and industrious Pennsylvania Dutch family and its descendants who lived at this location from 1765 to 1913.

There are fourteen buildings at Quiet Valley. Some are the original buildings, and some have been reconstructed. On a tour the role players take you back in time to relive the story of a family and to observe the activities typical of eighteenth and nineteenth century farm life.

Cover woodcut by Penny Ross

QUIET VALLEY
Living Historical Farm

1988 — 25th Anniversary

Theme: A COUNTRY FAIR

NEW!

Adventure In Old Time Living

Experience hands-on activities: a day in the life of your ancestors. Choice of:

Bread Baking • Spinning

Ice Cream Making • Animal Care

• Gardening

Fridays — 10 a.m. to 3 p.m.

Reservations required

1988 SUMMER HIGHLIGHTS

From 10: 30 a.m. to 3 p.m.

June 25	Fleece to Shawl
July 8	Nature's Garden
July 14	Rye Straw Hatmaking
July 20	Oak Split Basket Day
July 28	101 Uses for Vinegar
August 18	Making Blue Ribbon Honey
August 24	Candle Dipping
August 30	Pickles and Pies

HARVEST FESTIVAL

October 8 & 9, 1988

CHRISTMAS GIFT SHOP

December 3, 1988	10 a.m. to 4 p.m.
December 4, 1988	12 Noon to 4 p.m.

Museum Tour Admission Discount Coupon

$1.00 OFF per Adult   50¢ OFF per Child

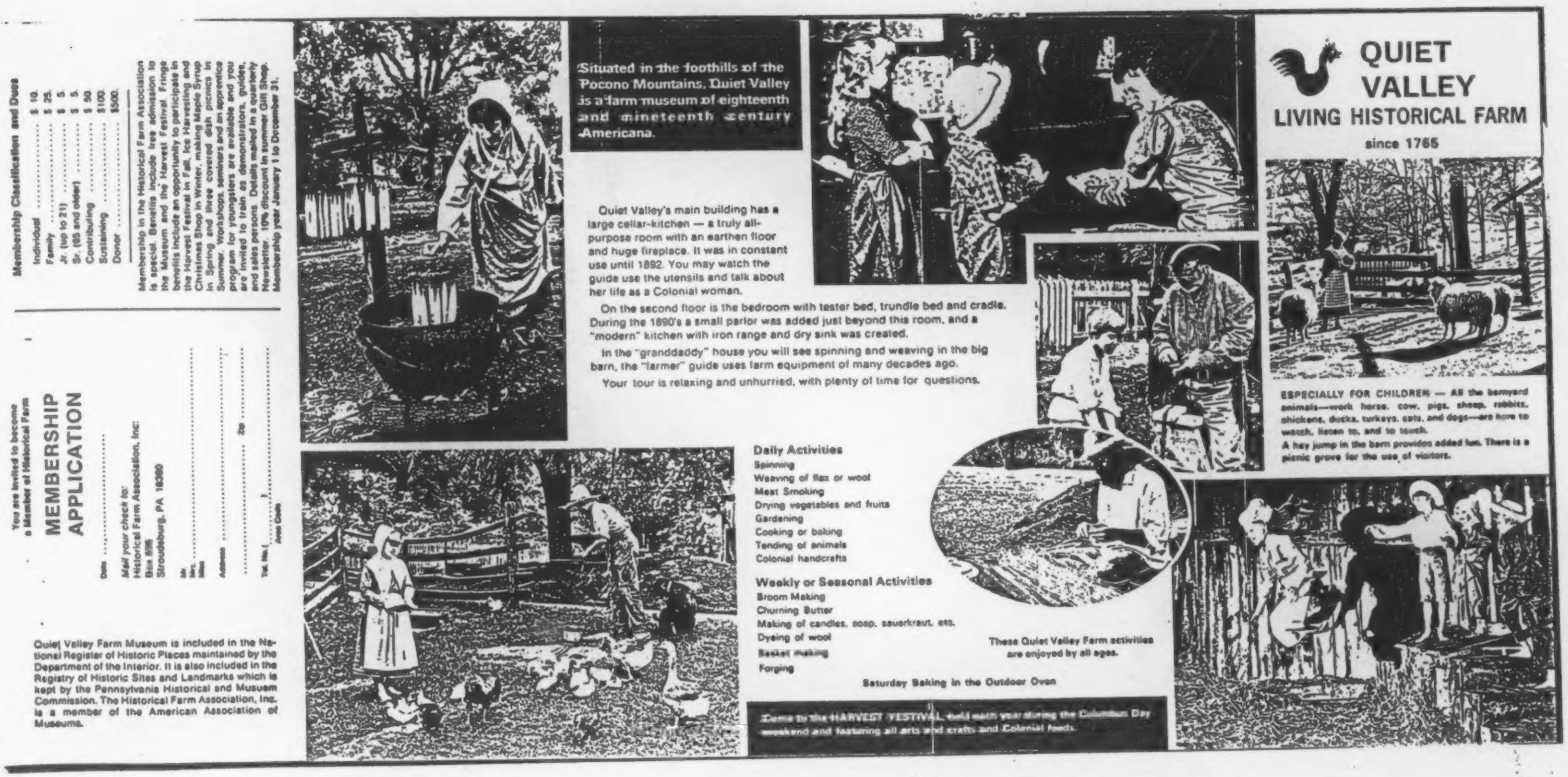
Limit $3.00 per coupon

Offer Good June 20 through Sept. 5, 1988

Not valid with other coupons.

All items subject to change.

Call to verify: (717) 992-6161.



QUIET VALLEY
LIVING HISTORICAL FARM
since 1765

Situated in the foothills of the Pocono Mountains, Quiet Valley is a farm museum of eighteenth and nineteenth century Americana.

Quiet Valley's main building has a large cellar-kitchen — a truly all-purpose room with an earthen floor and huge fireplace. It was in constant use until 1892. You may watch the guide use the utensils and talk about her life as a Colonial woman.

On the second floor is the bedroom with tester bed, trundle bed and cradle. During the 1890's a small parlor was added just beyond this room, and a "modern" kitchen with iron range and dry sink was created.

In the "granddaddy" house you will see spinning and weaving in the big barn, the "farmer" guide uses farm equipment of many decades ago.

Your tour is relaxing and unhurried, with plenty of time for questions.

ESPECIALLY FOR CHILDREN — All the barnyard animals—work horse, cow, pigs, sheep, rabbits, chickens, ducks, turkeys, cats, and dogs—are here to watch, listen to, and to touch.

A hay jump in the barn provides added fun. There is a picnic grove for the use of visitors.

Daily Activities

Spinning
Weaving of flax or wool
Meat Smoking
Drying vegetables and fruits
Gardening
Cooking or baking
Tending of animals
Colonial handcrafts

Weekly or Seasonal Activities

Broom Making
Churning Butter
Making of candles, soap, sauerkraut, etc.
Dyeing of wool
Basket making
Forging

These Quiet Valley Farm activities are enjoyed by all ages.

Saturday Baking in the Outdoor Oven

Come to the HARVEST FESTIVAL held each year during the Columbus Day weekend and featuring all arts and crafts and Colonial foods.

You are invited to become a Member of Historical Farm

MEMBERSHIP APPLICATION

Date ....

Mail your check to:
Historical Farm Association, Inc.
Box 838
Stroudsburg, PA 18360

Mr.
Mrs. ....
Miss

Address ....

.... Zip ....

Tel. No. (   ) ....
Area Code

Quiet Valley Farm Museum is included in the National Register of Historic Places maintained by the Department of the Interior. It is also included in the Registry of Historic Sites and Landmarks which is kept by the Pennsylvania Historical and Musuem Commission. The Historical Farm Association, Inc. is a member of the American Association of Museums.

Membership Classification and Dues

Individual	$ 10.
Family	$ 25.
Jr. (up to 21)	$ 5
Sr. (65 and older)	$ 5
Contributing	$ 50
Sustaining	$100.
Donor	$500.

Membership in the Historical Farm Association is special. Benefits include free admission to the Museum and the Harvest Festival. Fringe benefits include an opportunity to participate in the Harvest Festival in Fall, Ice Harvesting and Christmas Shop in Winter, making Maple Syrup in Spring and three covered dish picnics in Summer. Workshops, seminars and an apprentice program for youngsters are available and you are invited to train as demonstrators, guides, and sales persons. Details mailed in a quarterly Newsletter. 10% discount in summer Gift Shop. Membership year January 1 to December 31.

Engineers, Geologists, Chemists, Hygienists and Scientists

Raba-Kistner
Consultants, Inc.

P.O. Box 690287, San Antonio, TX 78269-0287
12821 W. Golden Lane, San Antonio, TX 78249, (512) 699-9090

April 11, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Proposals in U.S. House of Representatives to
Curb Nonprofit Competition

Dear Mr. Leonard:

I am writing as Chairman of the Board of a multi-disciplined firm providing both testing and consulting services to the public and private sector. Our firm employs over 175 professional, technical, administrative and support personnel with offices in three major metropolitan areas. Our firm is becoming more and more subjected to unfair competition from nonprofit organizations.

Raba-Kistner Consultants, Inc. typically are involved in the building and construction industries and the environmental risk management sector. Our work product, consulting and testing is routinely used in making decisions that effect the health, welfare and safety of the public. Our firm is registered, certified and insured in all possible areas. We are organized to compete effectively and aggressively in a market place that treats everyone equal. However, each year unfair competition from nonprofit organizations intensifies and is having a devastating impact on our company and its employees.

The work that your committee is currently involved in can provide relief to our company and industry, as well as other parts of the private sector throughout the United States. If one objectively looks at the work product from the engineering and scientific community, it's easily identified as "testing for public safety". The argument used by nonprofit competition to promote themselves because of this argument is unacceptable.

Speaking as a businessman, this unfair competition is making it impossible to reinvest in our company as well as guarantee employment of our professional, technical and support personnel. We hope that members of the House of Representatives will act quickly and fairly to insure that all of the players are following the same rules in our free enterprise marketplace.

Please call me 512-699-9090 if you have any questions or if I may be of further assistance.

Very truly yours,

RABA-KISTNER CONSULTANTS, INC.

Carl F. Raba, Jr.

Carl F. Raba, Jr., Ph.D., P.E.
Chairman of the Board

Miracle-Ear

April 13, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

We are a franchised Miracle-Ear dealer in northwestern Montana. We are one of the larger hearing aid dealers in Montana with other offices in Havre and Billings, Montana.

In most areas of Montana, over the past ten years, we have seen a dramatic growth in the Easter Seal hearing aid business. This organization has evolved in ten years from a non advertised entity with occasional hearing aid fittings on children, to a full scale competitor. Their advertising appears regularly and their dispensing has expanded to adult fittings as well as children.

I have no problem with another competitor as we have many. I do have a problem with the fact that they are a "non-profit organization" which definitely limits their overhead as far as a non tax status which permits them to sell essentially the same product we do at a substantially reduced price to the consumer.

The above mentioned information is bad enough but when you add to it the fact that my tax dollars help buy their test equipment and help pay their salaries, is it any wonder that I don't contribute at our local Easter Seals fund drive?

This unfair competition is definitely taking part of my business.

Very truly yours,

Byron Randall

Byron Randall, President
Rocky Mountain Hearing Aid
Company of Montana, Inc.

BR:dr

126 2nd St. East
Kalispell, MT 59901
1-406-755-5077

LAW OFFICES OF
MORRISON & FOERSTER

SAN FRANCISCO
PALO ALTO
WALNUT CREEK
LOS ANGELES
ORANGE COUNTY

2000 PENNSYLVANIA AVENUE, N. W.
SUITE 5500
WASHINGTON, D. C. 20006-1812
TELEPHONE (202) 887-1500
TELEX 90-4030
TELEFACSIMILE (202) 887-0763

NEW YORK
DENVER
LONDON
HONG KONG
TOKYO

WRITER'S DIRECT DIAL NUMBER
(202) 887-1550

April 15, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Re: Unrelated Business Income Tax
Response to Discussion Options

Dear Mr. Leonard:

This letter is in response to the Subcommittee on Oversight's request for public comments on certain Discussion Options relating to the unrelated business income tax that were contained in a press release dated March 31, 1988.

Specifically, this letter responds to the second sentence of Option VI, which states: "[r]etain character of debt-financed income received from all pass-through entities." Although the meaning of the quoted sentence is unclear, Subcommittee staff informally told us that the Option was intended to restate section 116(a)(5) of H.R. 4333, the Technical Corrections Act of 1988 ("TCA"). Such section of the TCA would treat section 501(c)(25) corporations as pass-through entities for purposes of the exception to the acquisition indebtedness rules contained in section 514(c)(9).

Morrison and Foerster is counsel for the RREEF Funds, which are the largest group of closed-end, tax-exempt real estate investment funds in the United States. During consideration of the Tax Reform Act of 1986, the RREEF Funds were actively involved in the enactment of the provisions relating to section 501(c)(25) corporations contained in section 1603 of the 1986 Act.

As discussed in greater detail in comments filed by the RREEF Funds in June of 1987 with regard to the TCA of 1987, the legislative history underlying section 1603 of the 1986 Act contains many unambiguous statements affirming that section 501(c)(3) shareholders of a section 501(c)(25) corporation were intended to receive the benefit of the section 514(c)(9) exception, even though such shareholders would not have been eligible for the exception if they had invested directly. See, e.g., Miscellaneous Tax Bills, Hearing Before the Subcommittee of Select Revenue Measures of the House Ways and Means Committee, 99th Cong., 2d Sess. 190 (May 19, 1986) (Treasury Department statement). Further, we were told by the revenue estimators who worked on this matter that the revenue estimates for section 1603 of the 1986 Act assumed that section 514(c)(9) would be applied on the entity level with respect to section 501(c)(25) corporations.

For these reasons, several Members of the Ways and Means Committee, including members of this Subcommittee, have indicated their opposition to section 116(a)(5) of the TCA. Any "back door" effort to codify any portion of the TCA before Congress has enacted it would make irrelevant the Committee's consideration of this issue.

If it decides to revisit this issue without regard to the TCA, the Subcommittee should reject this Option for the same substantive reasons that we have expressed in the technical corrections process. As discussed in more detail in our prior submission, section 514(c)(9)(C)(iii) should not be changed because there is little or no sound tax policy reasons why pension plans, governmental retirement plans, governmental units, colleges and universities should qualify for the acquisition indebtedness exception while other section 501(c)(3) charities do not.

This is especially true in a commingled real estate context, because a major purpose of section 501(c)(25) was to create a vehicle for many types of tax-exempt organizations and to provide each such participant with the same tax treatment as available to the others. Without this exception, non-college charities such as private foundations would be disadvantaged by a debt financed investment by a section 501(c)(25) corporation, thereby making it unlikely that such charities would invest in a section 501(c)(25) corporation that has pension plans, governmental retirement plans or governmental units as shareholders.

In any event, we believe that the proper focus for this discussion should remain with the Committee's consideration of the TCA.

Thank you for this opportunity to present our views.

Sincerely,

Tony M Edwards

Tony M. Edwards
Counsel for the RREEF Funds

TME:ad

April 13, 1988

James L. Saad
204 South Main Street
Cape May Court House, NJ 08210

Representative J. J. Pickle
c/o Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Representative Pickle:

We write to you in order to offer our strong support regarding reform of the UNRELATED BUSINESS INCOME TAX (UBIT) system as it pertains to non-profit organizations.

It is our opinion that the subcommittee's proposed package of reform measures are not only excellent but essential, and we commend you for your diligence on this matter. Our hope is that all of the proposed measures would appear as written in the subcommittee's final report. Also, it is imperative that UBIT be applied to all hearing aid sales income of nonprofits as there is no doubt of their commercialism. Furthermore, the "convenience" exemption for patients should be repealed or "patients" should refer only to inpatients.

Representative Pickle, the detrimental impact that nonprofit organizations have imposed on the tax paying businesses in our small community and all others around our country if not addressed will only worsen. Unfortunately, the rapidly growing number of hearing handicapped in our country will be severely affected by the lack of local services presently available to them by the highly qualified and dedicated hearing aid specialists who through unfair competition are being forced out of business, not to mention the loss of tax revenue derived from their success.

We thank you for considering our opinions and make ourselves available to you in anyway you deem beneficial to the adoption of these reforms.

Sincerely,

JAMES L. SAAD

JAMES L. SAAD, JR.

SACRED HEART LEAGUE
Walls, Mississippi 38686

April 15, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I just learned that the Subcommittee on Oversight is interested in receiving comments on the discussion options set forth in a recent press release. I am unable to have this material in your hands by the deadline specified, but have decided to forward it regardless in the hope that you will be able to accept it a few hours late.

The issue I would like to address is the proposal to apply Unrelated Business Income Tax to travel and tour services.

My understanding is that exemption from UBIT is suggested for certain, specified types of education travel. I surely agree with the rationale behind that proposed exemption.

My strongest belief is that there is a no less compelling argument for the exempting of true religious travel offered by a bonafide religious group.

Such an exemption could be based on compliance with a few surprisingly simple criteria:

1) Is the sponsor a recognized religious entity?

By the IRS, by any association of churches, or, if Catholic, by annual listing in the Official Catholic Directory.

2) Is a religious, spiritual, or "pilgrimage" image conveyed by the itinerary?

Itineraries become historical hard copy detailing day by day, often hour by hour, accounts of what happened on the trip.

It would be incumbent upon the sponsoring religious organization to maintain permanent records, including itineraries, chronicling trips it claimed as exempt. The burden of proof would be upon the organization to produce documented evidence upon audit that the trip did, in deed and in fact, have a verifiable religious purpose and intent.

Normally, "off-the-shelf" itineraries that are readily available from commercial suppliers would not qualify for exemption from UBIT.

Documents could easily be scrutinized for evidence of the religious intent and purpose of the journey:

Was there daily prayer? Were there daily religious services?

3) Did a recognized religious figure escort the trip?

A bonafide religious journey will always be accompanied by a religious leader appropriate to the nature of the group: minister, preacher, priest, religious sister or brother.

4) Did the religious organization purchase the travel package from a retail travel agency?

It should, in order to avoid unfair business practice and unfair competition with for-profit businesses. An alleged religious trip purchased directly from a tour wholesaler would be immediately suspect and would not ordinarily qualify for exemption.

5) Was the purpose of the trip to earn a profit for the religious organization?

If the answer is "yes," then the trip would be liable for the imposition of UBIT.

The Sacred Heart League has conducted pilgrimages since 1981. Our contention is that our journeys are truly religious, serve a very specific religious purpose for participants, and are a reasonable activity for the Sacred Heart League.

We would further argue that only the Sacred Heart League (or some other religious organization) is in a position and has the capability of producing a truly religious journey for co-religionists.

Our firmly held view is that no TWA "Getaway" package, or American Express package, or any other--even though offered to the same destinations as our Sacred Heart League's pilgrimages--can serve the same purpose and serve it as well.

We believe that no legislative action should be taken that makes it impossible for us religious organizations to do what we do best and what only we can do.

We believe that to encumber our pilgrimage activity (usually, one each year) with the necessity of filing UBIT tax reports which would ultimately show only that this is a non-profit activity on which no tax is ever due would be an unnecessary and wasteful deployment of everyone's time: ours and the IRS's.

Surely, language could be crafted which would exempt religious travel from UBIT, if that travel could qualify under such guidelines as have been iterated herein.

I shall be happy to offer such additional information to you and the Committee as you would deem helpful or appropriate.

Respectfully,

Roger Courts
Director

San Francisco
MODERN

April 14, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight,
Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Congressman Pickle:

I am writing to comment on your study of unrelated business income tax as it relates to non-profit organizations in general and the museum community in particular.

The changes you were considering in the test of museum shop, mail order catalog, and travel and tour services would have an extremely damaging impact on art museums' earned income possibilities. In the case of the San Francisco Museum of Modern Art, and most other art museums with which I am familiar, these earned income activities are not only sources of urgently required operating revenue that support the institution's cultural mission, but they are also important adjuncts to the museum's programming. In offering a well considered inventory of program-related items in our shop and our catalog, we expand the public's opportunities for education and appreciation of the visual arts. In our art rental gallery operation, we make available works of art of quality to a wide clientele of beginning private collectors and corporations while at the same time achieving a laudable goal of giving artists an opportunity for economic return and for exposure of their work. In our travel program we provide our members and friends of the museum with chances to undertake educational, art-related trips and tours that enhance their appreciation and understanding through the expert resources we are able to provide, the result being better informed and more generous patrons of the museum.

At a time in which the Administration and Congress have (through the implications of the recently adopted tax reforms, the absence of any significant increase to the federal funding of the National Endowment for the Arts, the National Endowment for the Humanities, and the Institute of Museum Services in recent years, etc.) urged charitable and cultural organizations to seek greater self-reliance and

401 Van Ness Avenue
San Francisco, California 94102-4582
415/863-8800

private sector support, it seems insensitive at best and cynical at worst for the government to seriously diminish our opportunities for development of earned income by drmatically narrowing the definition of what is related business income.

At the San Francisco Museum of Modern Art nearly $750,000 of our $6 million annual budget is provided by net earned income. To lose even a fraction of this would seriously impair our ability to carry out our important mission of exhibiting, educating, preserving, and collecting works of twentieth century works of art for our community. It is a difficult challenge to maintain a vigorous artistic program in a climate in which at federal, state, and local levels, government participation in supporting the arts is at best flat and in most circumstances declining.

Please take these serious concerns into consideration as you deliberate, keeping in mind that the earned income from various museum activities is crucial to the artistic health of our museums and to our ability to serve our constituents and yours.

With kind regards,

Sincerely yours,

John R Lane

John R. Lane
Director

JRL:sr

cc: Congresswoman Nancy Pelosi

San Francisco Symphony

HERBERT BLOMSTEDT, MUSIC DIRECTOR

MRS. JOACHIM BECHTLE
PRESIDENT

PETER PASTREICH
EXECUTIVE DIRECTOR

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The San Francisco Symphony is responding to the request for public comments from the U.S. House of Representatives' Ways and Means' Subcommittee on Oversight with regard to the Subcommittee's discussion options on the Unrelated Business Income Tax.

We would like to express our grave concern about the dangerous financial impact these proposed taxes would have on the San Francisco Symphony and every non-profit organization in this country. With the continued decline in government support for the arts at every level -- federal, state and local -- and the increased competition for private support from individuals, corporations and foundations, non-profit organizations, out of necessity, have had to rely more extensively on earned income to support program activity. To impose a tax on this activity would, in effect, penalize non-profit organizations and their efforts to stabilize their financial positions.

In 1986-87, the San Francisco Symphony generated over 13 million in earned income, primarily through concert ticket income, or 63% of its total operating budget of 21.3 million. Contributed income for the same period was 7.9 million or 37% of the Symphony's total operating budget. This earned income base supports the Symphony's annual concerts and a battery of community outreach programs that make the Symphony experience available to many individuals who might not otherwise be able to attend. These programs include an annual free concert that is attended by over 20,000 people, a series of children's concerts that introduce over 30,000 young people to the Symphony each year and a subscription discount program for senior citizens and students. Each of these programs would be threatened if the Subcommittee on Oversight's options are passed into law.

The Subcommittee options for possible taxable activity that would most adversely effect the San Francisco Symphony include: 1) taxation of all off-premise sales, including those through mail and phone-order, 2) taxes on on-premise gift shop sales and 3) taxes on travel and tour services. In 1987-88, through phone-order subscription ticket sales alone, the Symphony generated over half a million dollars.

We would also like to express concern regarding the language of the present discussion options. It is not consistently clear what activities would or would not be considered taxable and this ambiguity leaves considerable room for broad interpretation and the possibility of significant financial hardship for non-profit organizations.

We urge you to review your Oversight Committee's options on Unrelated Business Income Tax and consider the devastating impact these taxes would have on every non-profit organization in the country, an impact that would far outweigh the benefits of those revenues to the U.S. Government.

If you have further questions about the impact of these recommendations on the San Francisco Symphony or if you need additional information, do not hesitate to contact me.

Very sincerely,

G. Michael Gehret
Development Director

GMG:lh

cc: J.J. Pickle
Charles Rangel
Andrew Jacobs
Harold Ford
Beryl Anthony
Ronnie Flippo
Byron Dorgan
Richard Schulze
Bill Frenzel
William Thomas
Raymond McGrath

Sandusky Audiology

Frank "Pete" Fox, M.A./CCC-A
CLINICAL AUDIOLOGIST
Licensed Hearing Aid Dispenser

1801 East Perkins Avenue
Sandusky, Ohio 44870
(419) 625-7339

"We're hear to help"

Robert J. Leonard, Chief Counsel
Committee on Ways and means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

April 12, 1988

Dear Mr. Leonard:

This letter is in regard to reform of the "Unrelated Business Income Tax", (UBITs) that applies to non-profit organizations. I feel it is extremely important that they be made to conform to the same rules that govern their for-profit competition. I am specifically referring to non-profit organizations that dispense hearing aids in direct competition with hearing aid specialists and dispensing audiologists. At the moment, they enjoy an unfair advantage. They do not have to pay tax on their profits, and they also enjoy vastly reduced postage rates. These people are competing directly against me, yet they have a special status that gives them a built in advantage.

A rose by any other name is still a rose and should be treated as such. To show you the unfairness, we can use an analogy of a football game. Is it fair to require one team to go 10 yards for the first down and require the other to go 5 yards, at the same time letting them have twice as many players? The answer to this question has to be a resounding NO! It is for this reason I am imploring you to require non-profit organizations abide by the SAME rules everyone else must abide by.

Small business is the backbone of this country and can compete with anyone as long as they are playing by the same rules. We are not asking for favored status, just that you treat us fairly. Is that too much to ask?

Respectfully,

Frank "Pete" Fox, M.A.

Frank (Pete) Fox, M.A./CCC-A

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April 12, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard, Congressman Pickle, and Members, Subcommittee on Oversight:

We are pleased to respond to your call for comment relative to the UBIT preliminary discussion options.

I. "Substantially Related" Test -- we suggest and recommend that this provision be retained as it now exists. This provision has worked well for many years. In many cases it is impossible to make a 100% clear definition about some activity. We feel that if an activity is substantially related to the exempt purpose of the organization and is not specifically regulated by statute, then that activity should not be subject to UBIT.

I.D. Travel and Tour Services -- you will find that a very high percentage of travel and tour services "offered" by not-for-profit organizations are actually conducted and administered by for-profit travel agencies and companies to whom the not-for-profit has awarded the contract. Most not-for-profit organizations do not have the resources, expertise, or contacts to conduct such programs without using the resources of commercial businesses. Therefore, if UBIT is applied to such activities, the regulations should be carefully written so that UBIT applications only cover those Travel and Tour Services in which the not-for-profit organization does not use the services of a for-profit company.

I.E. Adjunct Food Sales -- may we caution the committee to clarify what is and is not covered in this item. Most 501(c)6 and 501(c)3 organizations regularly conduct educational seminars, workshops, conventions, etc. Often meals are served during these events. In almost every case these meals are purchased by the sponsoring association from a hotel, convention center or caterer which is a for-profit entity. Unless these functions are clearly excluded from UBIT, there would be double taxation on the same food service.

I.J. Advertising Income -- over the last few years there have been several tax changes and court interpretations relating to advertising income of not-for-profit organizations. As this area has probably had more scrutiny and been subject to more change than any other, I would recommend that no new changes be implemented by the current Congress.

I.L. Additional Specified Activities -- this section of page 2 does not define what activities. It seems to me to be inappropriate to have such a "miscellaneous" statement when you are addressing anything as complex and diverse as the U.S. Tax Code. I recommend that Section "L" be struck until such time specific proposals are distributed and comments solicited in the same manner as your overall Press Release #16, March 31, 1988.

V. Deduction from Taxable UBIT -- I support the proposal to increase the deduction to $10,000. Many "unrelated" activities of non-profits are so small and so inconsequential in comparison to their overall "related" activity, that such a deduction is needed. Otherwise the work load on the organization and the IRS will increase substantially more than the value of the tax generated.

VIII. Allocation Rules -- may I recommend a definition be established governing the portion of use for "unrelated" activities be established before the inactment of such a rule. When the "unrelated" activity is substantial, say 33 1/3% or more, then there seems to be merit in this idea. However, many not-for-profits may only have 1% or 2% of their activity defined as "unrelated." In those cases the proportionalization of operating costs will be so insignificant as to cause an unnecessary record keeping burden.

X. Miscellaneous -- both paragraph one re social clubs and paragraph three re non-refundable loans, mention investment income. These provisions do not specifically address the proposal made in the House in 1987 to tax the investment income of 501(c)6 associations. However, I would like to go on record as opposing that tax for many reasons I have previously sent to members of the Ways & Means Committee and Senate Finance Committee.

Paragraph five wories me as it is very vague and does not in this Press Release #16 identify those specific "piecemeal" items in which you have an interest. For example in 1976 and 1984 there were amendments adopted in the Tax Code relative to clarifying that trade shows sponsored by 501(c)6 and 501(c)3 organizations were "related activities." We would strongly oppose any attempts to modify that issue.

Thank you for permitting us to address the UBIT preliminary discussion options.

Respectfully,

John M. Crawford, CAE, CMP
President

Shaker Lakes Regional Nature Center
2600 South Park Boulevard Cleveland, Ohio 44120-1699 216 321-5935

RICHARD A. HORTON
Director

April 12, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

On behalf of the Shaker Lakes Nature Center, and my fellow museum professionals, I must express alarm about the Oversight Subcommittee's "discussion options" on the issue of taxation of nonprofit revenue-producing activities.

At a time when the federal government has reduced direct aid to the nonprofit museum community, eliminated the individual taxpayers deduction for charitable gifts if they do not itemize, and raised nonprofit postage rates; the thought of further curtailment of income to nonprofits seems unthinkable.

The nonprofit community of museums is struggling now -- particularly the smaller local organizations -- to fulfill the national need for cultural, scientific and nature related research, education and exhibition. Areas such as museum gift shops, tours and travel programs and off premises sales are one small but significant way that we can remain viable.

I urge you to carefully consider the options. Please do not curtail further one of the few ways nonprofits can support themselves and remain a viable part of American society. The alternative is to have fully federally subsidized institutions, which just doesn't seem like our way of doing things.

Sincerely yours,

Richard A. Horton

cc: Hon. Louis B. Stokes

SUPPLEMENTAL STATEMENT OF SHRINERS HOSPITALS FOR CRIPPLED CHILDREN CONCERNING TREATMENT OF CERTAIN UNRELATED BUSINESS ACTIVITIES OF EXEMPT ORGANIZATIONS

April 15, 1988

Shriners Hospitals for Crippled Children
P.O. Box 25356
Tampa, Florida 33622

813/885-2575

I.

INTRODUCTION TO SHRINERS HOSPITALS FOR CRIPPLED CHILDREN

Shriners Hospitals for Crippled Children is a public charitable institution comprising 22 free hospitals for the treatment of orthopaedic diseases and defects, and burns injuries, of children before reaching their 18th birth date. Twenty of these units are located in the United States, one unit is in Montreal, and one unit is in Mexico City. In 1987, the system was supported by contributions, bequests and gifts of $153,425,094, investment income (including capital gains) of $337,114,433 and estimated unrelated taxable business income of $100,000 (loss). Shriners Hospitals for Crippled Children has never purchased any unrelated business and each business activity conducted by it has been inherited through a bequest from a benefactor. 1/

Last year the system provided inpatient care for 17,106 children and out-patient care for 145,882 children. This meant 40,837 surgical procedures including 13,800 operations and 404,321 rehabilitation modalities. In addition to providing free hospital care for children, approximately $14,017,000 was expended on research primarily in the area of bone diseases, regeneration of the spinal cord, burn pathophysiology and artificial skin. All research costs are borne by our endowment. 1987 expenditures for capital improvements, medical and hospital care, overhead and fund raising approximated $190 million. Fund raising costs were 0.006 percent of expenditures.

1/ "Unrelated Business Income Tax," Hearings Before Subcommittee on Oversight of the Committee on Ways and Means, 100 Cong., 1st Sess., June 26, 1987 (Vol. 2), at 935, hereafter "1987 UBIT Hearings." Our inherited unrelated businesses include working interests in mineral properties, farms, ranches and fruit groves, and debt financed rental property.

In 1987, Shriners Hospitals for Crippled Children received zero dollars from the United States of America in the form of grants or welfare payments, received the sum of zero dollars from state and local governments in the form of grants or welfare. 2/ The Board of Trustees of Shriners Hospitals remains completely committed to taking no federal or state financial assistance in any form, at any time, for any purpose. The existing exemptions provided in Subchapter F of the Internal Revenue Code, and the charitable contribution deductions are, as a matter of law, not treated as "federal financial assistance", but the tax incentives do have a direct, significant and continuing effect on the ability of the organization to serve the public. Further details of our public service were presented to the Subcommittee earlier. 3/

II.

SUMMARY OF IRREGULAR BUSINESS ACTIVITIES SPONSORED BY SHRINE TEMPLES AND CLUBS

During 1987, there were 189 Shrine Temples and more than 1,500 Shrine Clubs affiliated with their Temples. Shrine Clubs are often dispersed outside the main geographic area of a Temple. In addition, as an integral part of all Shrine Temples are a variety of specialized units including band units, parade units, clown and entertainment units. During 1987, our Temples and Clubs conducted almost 200 different fund raising events for our charity. None was conducted by Shriners Hospitals for Crippled Children. Gross receipts from all events approximated $15.4 million and of that sum, Shriners Hospitals for Crippled Children realized about $10 million. The difference represented the cost of goods sold, out of pocket expenses and reserves for start-up costs for ensuing years' events.

A substantial number of events (primarily circuses) are conducted by Temples and Clubs for fraternal purposes. However, when the Hospitals' name and logo are used, 100 percent of the events' profits must be paid over to it. Although neither Shriners Hospitals nor The Imperial Council A.A.O.N.M.S. keep records on the total revenue raised from fraternal fund raising events, we believe that net income is fairly substantial.

2/ In contrast: "As the Chair and the Members well know, this mission [of serving the sick, regardless of financial status] has been clouded by a market place free enterprise approach to problem solving, and those who work with Medicare have heard from 6,000 hospitals which is all (sic) the hospitals in the country and each one is going bankrupt next year unless we give them more money in the Medicare system." Statement of Rep. Stark, 1987 UBIT Hearings at 766-767.

3/ 1987 UBIT Hearings, at 938-939.

The events were as different in scope and size as can be imagined. One Temple sponsored a tractor pull which grossed $6,900 and netted the Hospitals $1,600. South Carolina Temples and their Clubs sponsored summertime "fish fries" which grossed $185,000 and which netted the Hospitals system, $84,000. In 1987, circuses and volleyball, basketball, baseball, golf tournaments were sponsored, as were skeet shoots, auctions, jamborees, horse shows, auto shows, helicoptor rides, roller skating contests, style shows, barbecues, Christmas plays, square dances, Shrine balls, waterski shows, and all star football games. Last fall saw the 52d annual Shrine Bowl of the Carolinas, pitting the finest of North Carolina's high school football players against those of South Carolina. Gross receipts from tickets, programs and concessions were about $290,000 and the net profit was about $125,000. Major expenses included liability insurance ($16,000), training camp ($47,000), printing ($21,000) and professional management ($24,000). All star football games, often of high school students, but including college players and professionals, throughout the United States, yielded $1.7 million in 1987. Shrine circuses yielded $707,000 for the Hospitals in 1987 (most Shrine circuses are fund raising events for Temple purposes). Once a year paper sales by Shrine Temples for Shriners Hospitals brought in $5.5 million in 1987. All of these events, conducted by Temples under authority of Shriners Hospitals entail thousands and thousands of hours of volunteer help. Yet, because many professionals (such as circus operators) are paid, it is doubtful that the Section 513(a)(1) exemption - uncompensated help businesses - would prove altogether useful.

The funds raised by the Shrine Temples inure to the indirect support of the Hospitals in many ways for which no accurate accounting is possible. There are 850,000 members working on behalf of the Temples in a number of respects:

1. Contacting individuals (not only members and spouses) about making gifts and bequests to the Hospitals;

2. Performing a variety of services among which are:

   (a) Providing transportation of patients and parents to hospitals without charge;

   (b) Conducting screening clinics for patients;

   (c) Serving in voluntary capacities in Hospitals in ways too numerous to recount, including numerous governance, business and administrative tasks;

   (d) Shriners' wives also perform volunteer services for the Hospitals, usually directly with the children;

   (e) Shriners serve on local hospital Boards and committees without expectation of any financial reward.

3. Generating publicity through parades and entertainment events, where service to the Hospitals and the units themselves create an interest in the charity.

Volunteer services are the sole reason that the Shriners Hospitals for Crippled Children's fund raising costs are so low. In 1987, our fund raising costs were 0.8 percent of gifts and bequests of $153 million, which is the envy of other charitable organizations. It is the best track record of any charitable organization of any significant size. Without this support, the fund raising costs of the Shriners Hospitals would increase substantially.

III.
LAW AND ARGUMENT

A.

The Subcommittee's extensive review of the unrelated business income tax originally was aimed at assuring that existing tax preferences, in the nonprofit sector, did not provide undue support for exempt enterprises competing with taxable counterparts or erode the income tax base by reason of expansive administration of existing law. 4/ In contrast, the new hearing 5/ seems to be aimed at establishing a plan to map out a comprehensive tax base for the nonprofit sector and, as a consequence, is probably looking to evaluate each unrelated business now exempted on a policy-by-policy and provision-by-provision basis, in order to enhance revenue and even out competitive situations.

There are at least three separate tax policies which suffuse the existing system of exemptions for unrelated businesses such as those modifications Section 512(b) and Section 513(a).

An income tax exemption provides a federal subsidy to encourage the types of activities which, oftentimes, are conducted by the Government itself. 6/ However, that "private sector substitute" argument is inapplicable in dealing with trade associations, social welfare organizations, labor unions and social clubs. 7/ There the exemption is an opportunity to retain within the mutual benefit organization a measure of the revenues derived from the circle of persons who are the users of the services offered by the mutual benefit organization. 8/

4/ Statement of Rep. Pickle, 1987 UBIT Hearings at 9-11.

5/ Press Release No. 16, Subcommittee on Oversight, March 31, 1988, announcing a new set of hearings in late April using invited witnesses.

6/ Taxation with Representation of Washington v. United States, 461 U.S. 540 (1983).

7/ Baltimore Health and Welfare Fund v. Comm'r, 69 T.C. 554 (1978).

8/ Glass Container Industry Research Institute v. United States, 25 AFTR 2d 70-537, 1970-1 USTC ¶9214 (W.D. Pa. 1970). McGlotten v. Connally, 338 F. Supp. 448 (D.D.C. 1972).

Charities have historically supported themselves in a variety of ways including user fees (e.g., tuition) imposed on those who can afford to pay without losing the recognition that they are also providing for the poor, the distressed or the underprivileged, and benefiting the public at large. It is also in recognition of the fact that user fees are often the best, and most discreet manner which can subsidize these programs for persons who cannot afford the care from a facility without third party assistance. Third party assistance often comes in the form of assistance from Government, but can also come in the form of additional revenues derived from "profits" attributable to the fee for service. Because Shriners Hospitals for Crippled Children has no fee for service arrangements, it must rely on the generosity of its donors, the skills of its investment managers and the loyalty of the individual Shriners in our Temples and the general public to supply all of the funds necessary to operate its free hospital system.

It would seem that a free hospital system, where not even the Government is called upon to pay for any inpatient or outpatient service or facility, is the highest and best use of tax free earnings. The monetary benefits which the Shriners Hospitals now enjoy from the irregular business exemption are substantial. And so is the purpose served, viz, that the needs of crippled and burned children are served without any charges whatsoever. No patient, by reason of economic condition, race, religion or national origin is denied any medical service for any medical emergency or need arising out of the covenant of care set forth in our governing instruments.

B.

Experience is an unruly but reliable teacher. In 1950, many well meaning institutions tried to deflect the unrelated business tax by arguing that the greater good was served when tax free business profits provided better classrooms, bigger scholarships and brighter futures for the nonprofit sector. 9/ Little recognition was given to market place distortions that were created (i.e., the uneven playing field) nor was much concern expressed that business managers of charitable institutions were minding the wrong store. 10/ In our judgment, reformation of the unrelated business tax should focus then on three important factors: Fair competition, abusive practices and disconcert in governance and mission in the charitable sector.

The Treasury Department and the private sector are concerned about two persons, one exempt, one taxable, competing for the

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9/ H. Rep. 2319, 81st Cong., 1st Sess., C.B. 1950-2, 380 at 409.

10/ Treasury Report on Private Foundations, February 2, 1965, at 44.

same consumer dollar. This concern is in recognition of the fact that with tax free profits, for which the not for profit organization can find easy credit, can broaden markets more readily, affect pricing, obscure product values, and create unregulated domains of investment capital, to the detriment of not only commercial enterprises, but the fisc itself. However, Shrine circuses of a week or so, Shrine all star football games, Shrine paper sales, or Shrine fish fries, are not competing in any ordinary sense for the same consumer dollar as that of anyone else. We are not aware of any instances where there has been a negative impact because of competitive considerations inherent in any of the Fraternal Order's irregular business activities. 11/ Because entrepreneurs are not intimidated, inhibited or discouraged in any meaningful way by irregular business activities, the lynchpin for many unrelated business income tax policy decisions is missing. Indeed, irregular business activity threatens no sector of the economy except the nonprofit sector since we believe that the attempt to tax this type of income would eventually lead to its disuse and later abandonment of healthy fund raising devices.

We are very concerned that if the Congress alters the treatment of irregular business income, many volunteers, including Shriners, and family members, and persons who have been served by our hospital system, will simply think that it is not worth all of their personal time and effort if the Federal Government is going to take a substantial slice from our revenue pie.

C.

There is no abuse nor exploitation or manipulation of various Internal Revenue Code provisions by irregular business activities. By their very nature, these activities are sporadic, occasional, intermittent and discontinuous. This is evident by the fact that, in the 38 years since the passage of the Revenue Act of 1950, only two decisions have been rendered by courts on the irregularity exemption. 12/ The Congress invited charities,

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11/ In your June hearings, 41 proponents testified in favor of increased taxation of the nonprofit sector but no business activity was mentioned which could be characterized as irregular. Likewise, of the 73 other proponents which (or also) furnished written statements, no claims of unfair competition arose from any irregular business activity. 1987 UBIT Hearings, 212, 270, 327, 499, 523, 533, 551, 581, 606, 622, 634, 640, 741, 751, 793, 809, 818, 823, 864, 866, 872, 879, 927, 1069, 1082, 1205, 1219, 1250, 1303, 1318, 1329, 1335, 1348, 1357, 1394.

12/ Suffolk County Patrolmen's Benevolent Association, 77 T.C. 1314 (1977), (Acq. C.B. 1984-1, 2). Parklane Residential School, Inc., 45 T.C.M. 988 (1983).

and others, to use the exemption since none of the tax policy considerations apparent in 1950, or 1969, suggested the "regularly carried on" requisite was capable of being stretched beyond reasonable boundaries.13/ An irregular business has very limited business opportunities, its horizons are confined, its credit and accumulation opportunities are negligible and real growth is unlikely. Its capital needs are modest or nonexistent, its employees are few, its volunteers many and its rewards measureable, except for a few exceptional cases. A tax exempt entity cannot realistically sell shares in or spin off an irregular business. Neither the Internal Revenue Service, the Treasury nor the taxable community, has asserted that irregular business activity is harmful to taxable enterprises nor adorned with any abuse potential. 14/ It is a sensible, practical and efficient way to have effective revenue sources in a nonprofit universe without excessive entanglement in commerce. Parenthetically, Shriners who were Members of the Senate during the 1969 reform process also believed that. 15/

IV.

DISCONCERT OF THE CHARITABLE MISSION

In 1965, the Treasury expressed strong concerns about private foundations' involvement in business enterprises. Part of that excellent report discussed the disconcert which managing an active enterprise has on the mission of charitable institutions:

13/ H. Rep. 2319, *supra*, at 458; Statement of Rep. Lynch, *Cong. Rec.*, June 28, 1950, 9366; Tax Reform, 1969 Hearings Before Committee on Ways and Means, House of Rep., 91st Cong., 1st Sess. at 5136-5145; for Shriners' testimony, see Tax Reform Act of 1969, Hearings Before Committee on Finance, U.S. Senate, 91st Cong., 1st Sess., on H.R. 13270, Part 2, at 1133-1142.

14/ 1987 UBIT Hearings, 23 (Treasury statement), 61 (I.R.S. testimony), 212 (Business Coalition testimony) "Among other factors to be considered would be whether the activity is regularly carried on or is an occasional or annual event like the Girl Scouts cookie drive. Such occasional activity does not constitute unfair competition." 1987 UBIT Hearings, Statement of Business Coalition for Fair Competition, at 223-224.

15/ *Cong. Rec.*, Dec. 9, 1969 (daily ed.), at S16262: Senator Williams [Responding to Senator Hansen]. "The unrelated business income tax does not apply to income from activities which are not carried on by such organization on a regular basis -- that is, incidental or sporadic activities such as the Senator mentioned, the Shrine circus or annual football game, and similar activities would not constitute engaging in a business."

> "[The] special virtue of the foundation assumes that the individual or group in control will, in fact, be devoted to the development of new areas [of charitable concern]. [T]hat the primary concern will be with social aims. But where a foundation becomes heavily involved in business activities, the charitable pursuits which constitute the real reason for its existence may be submerged by the pressures and demands of the commercial enterprise. The directors of a foundation which own 26 wide diversed businesses must necessarily devote a very considerable portion of their time and energies to the supervision of business affairs; and the charity's claim upon their attention may well suffer. Business may become the end of the organization; charity, an insufficiently considered and mechanically accomplished afterthought. Little may remain to distinguish the directors of such a foundation [or such a charity] from the self perpetuating management of a publicly owned business corporation, without the balance supplied by watchful shareholders. Unrestricted involvement in business may, then, undermine the variability of the private foundation to make its unique contribution to our society." Treasury Department Report on Private Foundations, Feb. 2, 1965 at 43.

The same may be said about any public charity owning a substantial or principal share of any active business enterprise. Governance may be deflected, programs set aside and appetites whetted with business opportunities rather than public service. The irregular business activities conducted by Shrine Temples and Shrine Clubs do not create this kind of misdirection. Irregular business activities pose no particular threat to the mission of the charitable enterprise which enjoys the fruits of the labors of Shriners. They give their time, they give their money and expect nothing in return except the satisfaction that comes from seeing a crippled child walk again.

V.
SUMMARY

There is no anti-competitive effect, there is no abuse of existing law, and there is no intrusiveness on the tax paying sector by irregular business activities. The only merit, if it can be stated as such, of repealing the irregularity exemption is that there may be a substantial amount of revenue involved for the Treasury Department. Since revenue raising should not be the primary purpose of the unrelated business income tax we see no basis for the Subcommittee to recommend repeal of existing law and disrupt years and years of quiet, consistent, and effective fund raising by charitable institutions.

Of Counsel:

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202/659-4772

SHUTTLE SERVICE, INC.
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THE EXPRESS

April 11, 1988

APR 1 9

Congressman J.J. Pickle, Chairman
Texas - 10th District
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Pickle,

It has been brought to my attention by the American Bus Association, of which we are a member, that you will hold a hearing April 15, 1988 regarding Non-Profit/Tax Exempt Competition.

Our company is a small charter/tour bus company which operates five buses. We have been in business approximately four years. During this period of time, it has been extremely difficult to generate sufficient revenue to pay the ever-increasing costs of doing business. Therefore, it is extremely important that non-profit organizations not be allowed to continue operating bus charters and tours in their present status, as this is unfair competition and has resulted in our company losing large amounts of revenue.

I trust we can count on you for your support in these very important hearings.

Sincerely,

Tom J. Curtis

Tom J. Curtis
President

TJC/lm

cc: Congressman Charles B. Rangel
New York - 16th District

Congressman Andrew Jacobs, Jr.
Indiana - 10th District

Congressman Harold E. Ford
Tennessee - 9th District

Congressman Beryl F. Anthony, Jr.
Arkansas - 4th District

Congressman Ronnie G. Flippo
Alabama - 5th District

Congressman Byron L. Dorgan
North Dakota - At Large

Norman R. Sherlock
American Bus Association
1025 Connecticut Ave., N.W.
Washington, D.C. 20036

STATEMENT OF THE SIERRA CLUB
DISCUSSION OPTIONS
ON UNRELATED BUSINESS INCOME TAX
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

Submitted by J. Michael McCloskey, Chairman
April 15, 1988

The Sierra Club, a tax-exempt organization under Section 501(c)(4) of the Internal Revenue Code, was organized in 1892 to promote conservation and appreciation of natural values and the outdoors. It has grown from a small regional outdoor organization to become an international environmental organization with over 440,000 members and more than 400 state and local groups. Sierra Club is led by volunteers elected by the membership; these volunteer leaders serve on national, state, and local boards, without compensation, and determine program and policy decisions. I am submitting this testimony on behalf of the Sierra Club to address the Discussion Options Relating to Unrelated Business Income Tax.

General Considerations

The options cited by the Subcommittee on Oversight are concerned, in one form or another, with improving the identification of "unrelated" income properly subject to tax. Certain of these options address the adequacy of current legal standards, rather than the adequacy of enforcement, and these substantive options sharply frame the core issues for general consideration.

One prominent suggestion is the replacement of the "substantially related" test with a test of "direct" relationship. In our view, this option presents interpretive and administrative difficulties not appreciably different from those found by some in existing law. The vagueness from which the "substantiality" test is alleged to suffer will also afflict the "directly related" test. The substitution of one elastic term for another shifts the language of the debate, not its substance. IRS' review of individual cases would be required under the "direct" option, precisely as it is required today under the substantiality standard. The outcomes produced by a direct standard might be different, perhaps more likely adverse to the exempt organization, but only because the mere change in law in these circumstances would suggest to the Service that Congress intended to impose a more stringent standard. The nature of this standard would remain unclear, and its meaning would emerge in haphazard -- and if current experience is a guide -- inconsistent fragments as individual cases are decided.

By changing the standard from substantial to direct, the Congress would merely effect a transfer of the substantive decision to the IRS with little constructive guidance to the agency, and none to the exempt community. The law changed to reflect this option would be new law, but by no means better law, and it would not resolve, and perhaps even worsen, any current confusion.

Debate in this area would be better directed by attending closely to the nature of the activity raising new UBIT issues. The Subcommittee release does note one option, apparently guided by this approach, which would retain the substantiality standard while taxing specific activities deemed "inherently commercial." This option is not soundly conceived, however, because it departs from a questionable premise -- that "inherently commercial" activities may be clearly identified -- and then imposes tax on specific activities which are not in all cases "inherently," nor in any practical sense, commercial. The programs historically carried on by the Sierra Club, which are reviewed below, clearly illustrate this point.

The substantiality standard that we have today will serve perfectly well if applied sensitively, as required, to the facts of particular cases. What is needed in the administration of this standard, and in this entire area, is a clearer view of the fundamental difference between exempt and commercial activities, between the incidental competitive impact and wholesale "unfair competition." The IRS has correctly looked to the nature, scope and motivation of any one activity to determine its commercialism. These remain the salient inquiries. Does the nature of the activity contribute substantially or importantly to the accomplishment of the organization's charitable or educational function? Is the scope of the activity appropriate to its intended purpose or on a scale so disproportionate that it would raise questions about a motive other than the exempt purpose? Does there appear from these and other relevant facts and circumstances a motivation primarily to produce income or a continuing and substantial fidelity to the organization's exempt mission?

It bears emphasis that while certain activities of tax-exempt organizations present, in some incidental manner, apparent competition for for-profit organizations, this competition is hardly worth the name. True nonprofits cannot, in any meaningful sense, compete; because they are bound by a mission which is charitable rather than commercial, they cannot behave like true competitors and respond freely and creatively to market forces or consumer preference. If an exempt organization publishes for members, a magazine devoted to exempt educational themes, it is by definition limited to the "market" for those themes. There is virtually no latitude for expanding the market or entering new ones by fundamentally changing the selection of material and including what does not serve the exempt purpose. The freedom to do exactly this is the hallmark of true competition, and this is what profit making commercial organizations do. Exempt organizations don't because their charitable function forbids it. They are limited in their actions, by the law and by their mission, to the core pursuit of objectives other than profit.

Claims of "unfair" competition can be fairly evaluated only by asking whether nonprofits are seeking competition with profit-making entities -- or whether the reverse is, in fact, true. For example, during the 1970's, many commercial firms began publishing books and calendars for sale similar to those offered by Sierra Club for many years. Further, the number of for-profit enterprises sponsoring nature tours like those of Sierra Club has grown dramatically. While the Sierra Club does not ask to be protected from competition, a regulatory standard which treats our activities as "inherently commercial" now, when they were not at the time we started them, imposes an inequitable burden. If we fail to attract commercial competitors to our efforts to reach the public, is the activity then not "inherently commercial?" The presence or absence of commercial competitors should not be relevant in determining whether exempt purposes are being fostered.

Moreover, the Committee should consider competitive concerns also from the vantage point of not-for-profit organizations, which frequently pioneer public-spirited services that no one else provides. Should the tax code discourage activities that nonprofit organizations have traditionally carried on and which contribute importantly to their exempt purpose, and reward those who move into the field by copying their products or services?

This standard would also be turning a blind eye to the fact that, unlike tax-exempts, such entrepreneurs often fail to invest any amounts from their earnings in any function with broad public benefit. Any surpluses of income over expense generated by tax-exempt sales and service activities, while modest, are typically plowed back into exempt programs. The Sierra Club's experience is instructive on this point. Our income surplus is invested in conservation programs in a number of ways. They permit the Sierra Club to assist in funding our Service Trips to restore wilderness areas. Revenues from our calendars offset losses from publishing books with limited sales potential on toxic pollution control.

The substantiality test as it now stands could, focused in this fashion and carefully applied, clearly distinguish nonprofit from commercial behavior. The options for changes do not offer any meaningful prospects for better policy, clearer legal standards, or administrative convenience. The Congress should stay with the current code and, with renewed effort and perhaps improved enforcement, make it work.

Sierra Club Programs

For 96 years, Sierra Club has remained committed in all of its activities to the fundamental objectives of educating the public and fostering volunteer efforts to protect the natural environment. These objectives are advanced by reaching out to our members and the general public through educational programs, materials, and publications, all of which share the common theme of promoting conservation.

In 1901, to expand public awareness and appreciation of the environment, we began to take members on outings to the High Sierras; we pioneered the idea of "adventure travel" to explore these natural areas. Today we take thousands of our members on backcountry trips all over the world. Our outing leaders educate participants about the areas through which they travel and attempt to convey the conservation ethic that is the cornerstone of Sierra Club's environmental efforts. Unlike similar trips conducted by other enterprises, these outings are typically led through sparsely travelled wilderness areas to ensure that we do not contribute to the overuse of many of our national parks. Moreover, thirty years ago we instituted Trail Maintenance and Wilderness Restoration Trips as a formal part of our outings program. The purposes of these Service Trips range from trash collection, to trail rehabilitation, to restoration of native vegetation - all efforts to minimize the environmental impact of human use and conserve these areas for future generations.

The Sierra Club also seeks to educate and inform its membership about conservation issues through regular publications circulated on the national, state and local levels. *Sierra*, a bimonthly magazine published by the national organization, covers environmental issues, and features essays on natural areas and special articles for children.

In the early 1960's, we pioneered the idea of large format, nature photography books and established a standard for quality. A few years later, we initiated the first line of photographic nature calendars. Like our outings, our books and calendars are designed to enhance appreciation of our wilderness and natural areas.

Historically, we have focussed our efforts on a small number of activities we believe are uniquely suited to accomplishing our chartered purposes - expanding appreciation and awareness of the natural environment. The Sierra Club has no interest in commercial enterprise for its own sake, or solely for the sake of raising funds. We have initiated these activities in an effort to provide a service or communicate a conservation message to large numbers of people, and we could not afford to provide the service or message without charge.

Commentary on Specific Options

Four proposed options for revision of the rules on Unrelated Business Income Tax deserve special comment.

1. Advertising Income

The proposed change in assessing taxes on advertising revenue received by a magazine of an exempt organization is most injurious and inequitable. The present rule looks at whether there is any surplus income derived from publishing a magazine after publishing costs and advertising costs are offset against circulation revenue and advertising income. The proposed rule would ignore other costs and tax gross advertising revenues after deducting only for direct advertising costs. Such a rule not only ignores the economics of publishing a magazine, but taxes an exempt organization's publications more heavily than a commercial publication. The Sierra Club's magazine operates at a loss even after offsetting income from advertising, but the new rule would ignore this loss and subject us to considerable tax. The proposed rule would impose a disproportionate tax on nonprofit organizations when compared to any commercial enterprises publishing magazines.

The present rule for determining taxable income with respect to advertising in a nonprofit publication may need clarification and fine tuning, but it is fair in its fundamentals. The economics of publishing a magazine must be viewed as a whole. Surpluses are not imagined where none exist, and the publication is properly viewed as part of a larger undertaking.

2. Treatment of Royalties

The proposal to tax royalties also is troublesome in that it broaches the doctrine that passive income is exempt. We do not understand why computing a royalty on a trademark - user's net profits, in contrast to gross revenues, is any less passive from the trademark owner perspective. In neither case is the trademark owner participating actively in the enterprise. While we note that one option would continue to exempt from taxes those royalties derived from products directly related to exempt purposes (and we think that is vital), the other and first mentioned option does not. If passive income is to be taxed, the financial viability of many nonprofits will be seriously jeopardized and incentives to save undermined. Moreover, in the second option, we see no logic in taxing a royalty based on a property right created by the tax-exempt organization, but exempting the royalty if the property right is donated. Does this mean that a logo donated to the Club will not generate a taxable royalty, but a logo that we pay for will?

3. Regularly Carried on Activities

Another proposed change would subject sales activity to UBIT even if it is only occassionaly carried on and done so by volunteers using materials they purchased. In our case, Sierra Club volunteers across the country purchase books and calendars to resell locally to members and others, particularly at Christmas time. These books and calendars relate exclusively to conservation and nature appreciation. The proposed change would subject these activities to UBIT. While the net revenues generated locally by these undertakings may not be great, cumulatively on a national basis the amounts would probably exceed the minimums of $5000 or $10,000. Subjecting these activities to UBIT would dampen enthusiasm for this activity and weaken the ability of many of our local units to involve Club members programmatically and raise the money needed each year for their budgets (they raise well over half of their budgets themselves through these volunteer activities). As a consequence, far less work for the exempt purposes of conservation would be accomplished. In many cases, imposition of UBIT tax would destroy the economic viability of their undertaking.

4. Allocation Rules for Indirect Expenses

Finally, we see no logic or justice in proposing to disallow the deduction of indirect expenses in connection with allocation of expenses to calculate UBIT for facilities used both for related and unrelated purposes. Indirect expenses for overhead and depreciation are real expenses, and dual-use facilities are sized to serve both related and unrelated purposes. It is only fair and realistic to allocate indirect expenses proportionately to both activities. To bar allocation to unrelated activities, puts an unfair burden on related activities. It also put a nonprofit enterprise at a competitive disadvantage vis a vis comparable commercial enterprises which are permitted under the Code to deduct such expenses.

Conclusion

In conclusion, the current "substantially related" rule for determining tax liability for nonprofits walks a sensible line between encouraging organizations to pursue a wide range of activities that advance their chartered exempt purposes, while taxing activities that go too far afield. We oppose any basic change in this rule and urge the Subcommittee to concentrate on clarifying the rules where necessary.

The Sierra Club appreciates the encouragement which the United States tax laws have provided to it and other not-for-profit organizations. Voluntary organizations have flourished in this country for many reasons, but recognition in the tax laws that they provide important public benefits and should be encouraged is one of them. In considering revisions to the laws which effect business income to tax-exempt organizations, it is important not to lose sight of these fundamental public benefits provided by the nonprofit sector.

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FREDERICK SIMPICH

ROSS D. DAVIS
OF COUNSEL

April 6, 1988

Russlyn Guritz, Esquire
Assistant Counsel
Subcommittee on Oversight
1105 Longworth
House Office Building
Washington, D.C. 20515

Re: Subcommittee on Oversight Options Relating to the Unrelated Business Income Tax

Dear Ms. Guritz:

I should like to comment on the unrelated business income tax "option" set forth in Item VIII, "Allocation Rules", of the Oversight Subcommittee's Press Release No. 16, dated March 31, 1988.

It was likely unintended on the part of the person who drafted this particular option, but the last clause could be interpreted to provide that when calculating unrelated business taxable income in respect of that portion of a facility used for unrelated business purposes, the affected tax exempt organization would not be allowed to charge a pro rata share of overhead and depreciation against the corresponding pro rata share of gross income derived from the facility.

If, on the other hand, this result was intended and the option should be embraced by the Subcommittee, the Subcommittee would deprive non profit organizations deductions from gross income that have since the inception of the Revenue Code been available to all enterprises whether profit oriented or not.

I question, moreover, whether there is any logical or historical defense for such a proposal. As you know, the history of the unrelated business income tax provisions of the Code shows the desire of Congress to level the field upon which small businesses and "entrepreneural" activities of non profits operate. To permit profit making organizations to deduct from gross income overhead and depreciation while denying that privilege to non profits would not only be unprecedented and discriminatory but also create a tilt against tax exempts that is wholly unwarranted in view of the limited purposes Congress has been seeking to achieve.

Very truly yours,

Frederick Simpich

FS:bvh

cc: Ms. Beth Vance

Slater Mill Historic Site
Roosevelt Avenue, P. O. Box 727
Pawtucket, Rhode Island 02862

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Friends:

I am writing as the Business Manager of a small 501(c)3 museum to comment on the proposed changes in the unrelated business income tax (UBIT). Specifically, we are opposed to any tightening of regulations regarding museum stores and bookshops.

Gift store sales are an important source of income to many museums. In a certain sense, museum stores do compete with for-profit businesses, especially nearby gift, souvenir, and book stores. However, museums also serve to attract visitors who not only patronize museum stores, but also do business with other nearby retailers. This phenomenon can be seen clearly in such communities as Sturbridge, Massachusetts and Williamsburg, Virginia. These cities support and benefit from a wide variety of private tourist-related enterprises. Some of these enterprises may regard museum stores as "competition," but most of them would not survive without the business generated by museum visitation. On a smaller scale, this takes place near most museum facilities. In 1987, our museum, which has a budget of less than $200,000 per year, attracted visitors from 47 states and six foreign countries to Pawtucket, Rhode Island, a small industrial city which would not otherwise be a focus of tourism.

In addition to the direct economic benefits of museum-related tourism, there is an issue of equity involved. To the extent that museums are supported by gift store sales and other similar activities, they are being funded by those who care about them and use their facilities. If these sources of revenue are removed or restricted, museums and other similar non-profits will be made more dependent on government funding, which will place more of a burden on those who do not use museum services and have no interest in them.

The impact of these proposed changes could be considerable. For example, our museum runs a school tour program which has been a feature of growing up in Rhode Island for more than 20 years. Slater Mill is the only facility in the state which concentrates on the history of Rhode Island's industrialization and on the history of its working people. Even with our prices set to the highest level we feel comfortable with, we lose money on our school program. We would lose even more were our tour guides not willing to work at well below market wages. Museum store sales provide the margin we need to continue the program. If tax regulations are tightened, we would have to seriously consider cancelling or curtailing the program.

I hope you will carefully consider -- and reject -- the proposed UBIT changes.

Sincerely,

Mark McDonough
Business Manager
Slater Mill Historic Site

ALFRED P. SLOAN MUSEUM

RECEIVED
APR 15 1988
Ways and Means
Subcommittee on Oversight

April 12, 1988

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Representative Pickle,

I am responding to your call for public comment on the unrelated business income tax and how they effect the Sloan Museum.

The Sloan Museum is a medium size facility with an $800,000 annual budget located in Flint, Michigan, an economically depressed area because of the reduction in work force of General Motors employees. Flint's population has decreased from nearly 200,000 in 1970 to 150,000 during the last census.

However, even with this decrease in population the Sloan Museum attracted over 175,000 people to participate in its program last year and we see even greater participation this year.

The museum derives about 40% of its budget from admissions, gift shop sales and gifts and grants.

Your proposal for UBIT on gift shop sales would cost our facility alone nearly 10% of our total gift shop sales, depending on the final bill not to mention that our bookkeeping cost would be increased.

Also, while we sell almost no merchandise off premises you must remember that museums as educational institutions conduct many classes off premises for first hand experience.

Sales of related items such as a Michigan History or Flint History publications are certainly a part of the museums educational purpose and the museum in some cases is the only place where they can be purchased locally.

I urge you and your committee to weigh carefully the impact your proposal would have on the nations cultural institutions, institutions that are already facing fiscal problems.

Sincerely yours,

Phillip C. Kwiatkowski
Director,

Accredited by the
American Association of Museums
ALFRED P. SLOAN JR. MUSEUM / 1221 E. KEARSLEY ST. / FLINT, MICHIGAN 48503 / PHONE (313) 762-1169 / PHILLIP C. KWIATKOWSKI, Director

Small
Business
Legislative
Council®

April 14, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

On behalf of the Small Business Legislative Council (SBLC), I wish to submit the following comments regarding options, developed by the Subcommittee on Oversight, to revise the unrelated business income tax. The Small Business Legislative Council (SBLC) is a permanent, independent coalition of over ninety trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of over four million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture. A list of our members is attached.

SBLC hopes the subcommittee will move swiftly to stem the tide of unfair competition by nonprofit entities. We believe that small business has established, beyond a shadow of a doubt, that there indeed is a problem that demands solutions. The record from last year's hearing demonstrate that fact conclusively. The options developed by the subcommittee address the breadth and depth of the problem. The subcommittee and its staff are to be commended for their efforts.

In Section I Substantially Related Test, the subcommittee has enumerated eleven specific activities that are inherently commercial in nature. From our experience, these activities do represent the substantial bulk of unfair competition, as the hearings last year revealed. I am sure some of SBLC's member organizations will offer suggestions to improve these recommendations to ensure the development of a truly level playing field. From our perspective, adoption of the specific recommendations would result in the effective end of unfair competition.

However, as an advocate for all small businesses, we believe the legislation must include strong language to permit a swift and definitive determination of whether activities, not included among the 11 enumerated activities, are inherently commercial in nature. The service sector is the fast growing segment of our economy. Small businesses are constantly opening new markets and nonprofits are constantly seeking to develop new revenue sources. As a result, the law must provide the necessary flexibility to encompass future endeavors.

We have long advocated a reversal of the current presumption that has evolved in the courts in favor of the nonprofits. Nearly any activity can meet the substantially related test as it now stands. We believe it is incumbent upon the nonprofit to demonstrate that the activity it is about to undertake is consistent with its basic charter and the objectives upon which our tax code grants favored status for tax-exempt organizations.

The reason the unrelated business income tax is ineffective is that it relies on determinations of motive in the already gray area of relatedness. It is a gray area because nine time out of ten, expansion is going to be built on existing resources and talents and thus will, in the commonly accepted sense, almost always be related. The macaroni factory cases are the exceptions rather than the rule. The presumption in current law and enforcement is that the purposes comes first, and the nature of the activity second. The Presbyterian & Reformed Publishing case (79 TC 1070 (1982), rev'd 743 F.2d 148 (1984)) illustrates this most graphically.

The solution is to reverse the logic. First, let us identify what are the commercial activities and then permit the nonprofit to demonstrate circumstances which would warrant continued performance of the activity. If an activity resembles a commercial activity it should be taxed like one. If the tax-exempt organization chooses to pay the tax then it should be permitted to carry on the function. Our objective is fair competition, not the elimination of competition. We recognize the need for some flexibility and would make the test a rebuttable presumption. The nonprofit could then demonstrate the need for its commercial services in the community. Therefore, from our perspective, the recommendations under Section I address the heart of the issue.

It is not our position to comment on recommendations II through VIII since these recommendations address the manner in which nonprofits execute their responsibilities rather than the nature of the business. While many of these reforms may be worthwhile, as representatives of small business our principal concern must remain with their inherently commercial activities. We hope the subcommittee will endorse those recommendations in Section II through VIII that will achieve a level playing field.

We are pleased that the subcommittee has chosen to identify several administrative reforms. We believe all parities agree that better information collection and enforcement is appropriate. We do not believe, however, that other reforms should be delayed. These administrative reforms should be enacted concurrent with other initiatives.

Finally, much has been written and said about the "players" in this issue. We wish to share with the subcommittee a recent editorial written by the SBLC Chairman. The attached editorial appeared in the Executive Update of the Greater Washington Society of Association Executives. We believe it summarizes our views on this important subject.

In conclusion, we are greatly hearten by the subcommittee's work and look forward to working with you to solve the problem of unfair competition.

Sincerely,

John S. Satagaj
President

JSS/0475
Enclosure

COMMENT

Wayne Smith

Why unfair competition is exactly that

Recently, much has been written about the hearings held last June by the Committee on Ways and Means. The subject of the hearings was the unrelated business income tax (UBIT). The small business community has charged that nonprofits are engaging in unfair competition with the for-profit sector. I would like to dispel the belief that this is a small business versus association issue. This is simply not true.

The Small Business Legislative Council (SBLC) is a permanent, independent coalition of over 90 associations. One of the most important facts about SBLC is that it is managed and directed by senior-level association executives. It represents a diverse range of interests from manufacturing to transportation and all areas in between. It therefore has a stake in both the association and small business worlds.

The prime objective of the SBLC is to assist association executives in responding to pertinent legislative issues. The SBLC is constantly alert to legislative matters and its goal is to deliver cost-effective and timely service to SBLC members.

The issue of unfair competition is not directed at trade associations. Trade associations are not unfairly competing with small business. Although trade associations and other nonprofits are governed by the same rules, an examination of the testimony before the Committee on Ways and Means reveals the true nature of activities which are unfair competition. These activities include laboratory testing, travel services, laundries, hearing aid and medical sales, veterinary services, and physical fitness and recreation services.

While entities such as the National Geographic Society and the YMCA were mentioned as competitors, the most frequently mentioned competitors were universities and hospitals. These entities are not associations. However, through activities like those outlined above, they have become small businesses under the "nonprofit" heading.

Several factors make unfair competition by nonprofits a serious problem for small business. Foremost among these is the fact that small businesses dominate the service sector. Ease of entry, low capital costs, and abundant human resources make the service industries ideal spawning grounds for small businesses. The expanding role of small business in the service sector coincides with the measurable movement of our economy towards a service-based economy. When all is said and done, small business *is* the service sector.

At the same time, the nonprofit community is best-suited for expansion into service markets. Universities, hospitals, and other nonprofits have both the facilities and the personnel. It is only a matter of applying a little creative planning to develop new markets for nonprofits. The reasons for their expansion into traditionally for-profit areas are obvious—declining revenues, increased costs, and excess capacity. Because of this, it's hard to fault the nonprofits; any small business would be expected to apply the same strategies under those circumstances. But nonprofits apply this strategy without the tax accountability of small business.

Another factor contributing to nonprofits' disproportionate impact on small business is the fact that the competition takes place in local markets. Professional and technical services do not lend themselves to national marketing strategies. Thus, competition generally pits one nonprofit against one local segment of the for-profit community.

The problem is that we have a nonprofit sector which is turning a considerable "profit" at the expense of the taxpayer and small business. At one time charitable entities had clear purposes and equally clear means of support. Now many have become growth industries which, for all intent and purpose, are unregulated.

Unfair competition arises from the fact that these nonprofit organizations may use their governmental exemptions or privileges to offer services at a lower price, to subsidize market entry, or to use the aura of the government imprimatur to win marketshares. This competition takes place within a marketplace of commercial activity; far from the typical programs of most associations.

We view the hearings of the Committee on Ways and Means as a positive step. First, it is to the benefit of our economy and job market to ensure that every association's business members have the opportunity to compete fairly. Second, it is an opportunity for the association community to clearly define the positive contributions made to our society through and by associations. ☐

Wayne Smith is the executive director of United Bus Owners of America. He is also chairman of the Small Business Legislative Council.

Small
Business
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Members of the Small Business Legislative Council

Alliance of Independent Store Owners and Professionals
American Association of Nurserymen
American Consulting Engineers Council
American Council of Independent Laboratories
American Dental Trade Association
American Electronics Association
American Floorcovering Association
American Machine Tool Distributors Association
American Society of Travel Agents, Inc.
American Sod Producers Association
American Subcontractors Association
American Textile Machinery Association
American Trucking Associations, Inc.
American Warehousemen's Association
Architectural Precast Association
Associated Builders & Contractors
Associated Landscape Contractors of America
Association of Physical Fitness Centers
Association of Small Business Development Centers
Association of the Wall and Ceiling Industries-International
Automotive Service Association
Automotive Warehouse Distributors Association
Building Service Contractors Association International
Business Advertising Council
Christian Booksellers Association
Electronic Representatives Association
Florists' Transworld Delivery Association
Helicopter Association International
Hobby Industries of America
Independent Bakers Association
Independent Bankers Association of America
Independent Insurance Agents of America, Inc.
Independent Medical Distributors Association
Independent Sewing Machine Dealers Association
International Association of Refrigerated Warehouses
International Bottled Water Association
International Communications Industries Association
International Fence Industry Association
International Franchise Association
International Reciprocal Trade Association
Latin American Manufacturers Association
Machinery Dealers National Association
Manufacturers Agents National Association
Mechanical Contractors Association of America, Inc.
Menswear Retailers of America
National Association for the Self-Employed
National Association of Aircraft and Communication Suppliers
National Association of Brick Distributors
National Association of Catalog Showroom Merchandisers
National Association of Chemical Distributors
National Association of Development Companies
National Association of Home Builders
National Association of Investment Companies
National Association of Manufacturing Opticians
National Association of Personnel Consultants
National Association of Plumbing-Heating-Cooling Contractors
National Association of Realtors
National Association of Retail Druggists
National Association of Small Business Investment Companies
National Association of the Remodeling Industry
National Association of Truck Stop Operators
National Association of Women Business Owners
National Candy Wholesalers Association
National Chimney Sweep Guild
National Coffee Service Association
National Council for Industrial Innovation
National Electrical Contractors Association
National Fastener Distributors Association
National Grocers Association
National Independent Dairy-Foods Association
National Machine Tool Builers' Association
National Motorcycle Retailers Association
National Moving and Storage Association
National Office Products Association
National Parking Association
National Precast Concrete Association
National Shoe Retailers Association
National Society of Public Accountants
National Tire Dealers & Retreaders Association
National Tooling and Machining Association
National Tour Association
National Venture Capital Association
Opticians Association of America
Petroleum Marketers Association of America
Printing Industries of America, Inc.
Retail Bakers of America
Small Business Council of America, Inc.
Smaller Manufacturers Council
Society of American Florists
Specialty Advertising Association International
United Bus Owners of America

1025 Vermont Avenue, NW/Suite 1201/Washington, D.C. 20005/(202) 639-8500

Smithsonian Institution
April 15, 1988

MEMORANDUM

Concerning Proposals before the Oversight Subcommittee for Changes in the Unrelated Business Income Tax

On March 31, 1988, the Subcommittee on Oversight of the Committee on Ways and Means of the U.S. House of Representatives issued a press release containing a series of proposals (referred to as "discussion options") for changes in the unrelated business income tax. These proposals are part of an on-going review by the Congress and the Treasury of the treatment of revenue-generating activities by tax-exempt organizations. The Subcommittee on Oversight has solicited comments on the discussion options, and has indicated that it will take such comments into account in developing legislative recommendations to the Ways and Means Committee.

A number of the subcommittee's proposals involve significant departures from present law. If legislation reflecting such proposals were to be adopted, it would have a substantial impact on tax-exempt organizations, like the Smithsonian Institution, that pursue a broadly defined program of public education.

The Smithsonian Institution carries on a wide range of educational activities, pursuant to its statutory trust mandate "for the increase and diffusion of knowledge among men." (20 U.S.C. § 41). Some of these activities are capable of generating income, although most of the Smithsonian's facilities and programs are offered to the public without charge. In all cases, however, the activities of the Institution contribute to its mission of _diffusing_ knowledge -- spreading understanding of history and of the human achievement -- not only to but also beyond the population of museum-goers and visitors within the District of Columbia. This was the purpose for which the Congress created the Smithsonian, and delegated to the Board of Regents (which includes members of the Senate and House of Representatives) the responsibility to determine which activities would best promote the Institution's broadly stated trust purposes.

Although the Smithsonian receives the major part of its revenues in the form of Federal appropriations and generous private gifts, the income generated by certain of its activities does provide an important source of support for the Institution's programs. Some of the proposals set out in the Oversight Subcommittee press release would result in a substantial tax burden on these activities.

Alternatives to the "Substantially Related" Test

The first of the Subcommittee's discussion options would involve repeal of the "substantially related" test. In its place would be either a "directly related" test, or a new requirement that each income-producing activity standing alone qualify as tax-exempt.

There is no way to predict the effects of adopting a "directly related" test, since nothing in present law indicates what a "direct" relationship would involve, or how the new test would differ in practical application from the present statutory standard. Adoption of a "directly related" test would leave exempt organizations without any solid basis for making judgments as to the tax consequences of their operations, and their ability to make prudent financial plans would be diminished. Moreover, the body of knowledge and experience built up in connection with the "substantially related" standard would be lost. It seems clear that the change from one subjective standard to another would not advance the purposes of the unrelated business income tax.

The second of the proposals set out in the discussion options would require each income-producing activity of an exempt organization to qualify separately as tax-exempt. Present law, through the fragmentation rule, already requires an evaluation of activities on an item-by-item or transaction-by-transaction basis, to determine whether the activity contributes to the accomplishment of a charitable or educational purpose. The new test would apparently require each activity of an exempt organization to qualify independently as charitable or educational, just as if the activity were not carried on within a larger charitable or educational context. This proposal (particularly in combination with elimination of the "convenience" exception) would be a major and unwarranted departure from present law.

"Inherently Commercial" Activities

The Subcommittee's press release indicates that, if a decision is made to preserve the "substantially related" test, tax might be imposed on specified activities "whose nature and scope are inherently commercial, rather than charitable". In the Subcommittee's discussion options, eleven categories of activity appear under a heading of "inherently commercial", but taxation of the income from such activities does not apparently depend on any actual determination of market operation or competitive effect. A statutory structure that depends, in such an arbitrary way, on characterizations of "commerciality" is bound to create anomalies, inconsistencies, and inequities.

Sale of Merchandise

The press release suggests (as the first of the rules for "inherently commercial" activities) that income of gift shops and bookstores be subject to tax, with exceptions for on-premises sales of low-cost mementos, on-premises sales of an educational nature which relate to the organization, articles in furtherance of educational programs, low-cost items, and a limited number of computer sales. All "off-premises" sales in excess of some de minimis amount would be taxed.

Identifying museum shops and catalog sales as "inherently commercial", thereby subjecting them to a presumption of taxability with specified exceptions, ignores the educational purpose and function of such activities. This is particularly evident in the proposal that would subject all off-premises sales, without regard to educational value or significance, to tax. This proposal could affect the Smithsonian in several ways.

The Smithsonian has a long and very important tradition of publishing scholarly books, books related to its collections, and books growing out of its very diverse research and international study programs. These books are given the widest possible distribution through mail-order sales to Smithsonian members and other interested individuals and educational institutions. Although these are works of unquestioned educational value, they may well be swept into the category of "off-premises" sales, and taxed without further inquiry. Such a change in the law would be a real disincentive to serious intellectual effort.

A more obvious effect of the subcommittee's proposal on off-premises sales would be the taxation of income from all museum catalog sales. For the Smithsonian, this would limit and discourage an important aspect of its public education program.

In view of its commitment to the broadest possible dissemination of knowledge, the Smithsonian has never limited its educational programs to the traditional forms of scholarly effort. The Smithsonian's catalog of museum-related items is one aspect of the Institution's effort to extend its educational mission to people throughout the nation -- those people who are in fact, without regard to residence, the beneficiaries of the original Smithson bequest which the Institution was created to administer. The sale through the catalog of reproductions and adaptations of items in the Smithsonian collection serves an educational function which is a valid part of the Smithsonian's mandate.

It is difficult to understand why catalog sales should be subject to an absolute rule of taxation, while sales of items in a museum shop are evaluated on the basis of educational significance or relatedness. The purpose of the sales in each case is the same; the educational effect should be the same; and the rule of taxation should therefore be the same.

Royalty Exception

The press release suggests that the exception to the definition of unrelated business taxable income for royalties should be modified to eliminate (and therefore to tax) any royalties measured by net or taxable income, as well as any royalties derived from the use of property created or developed by the exempt organization. A tax on royalty income would have a significant financial effect on a wide range of exempt organizations, and a substantial impact on a number of museums, including the Smithsonian. Such a tax would represent a departure from what has been the fundamental premise of the unrelated business income tax: that exempt organizations should be subject to tax only when they are actively engaged in the conduct of an unrelated business, potentially in competition with taxable business enterprises.

Royalty income is by definition passive income, and the unrelated business income tax statute since enactment has recognized that it should not be subject to the tax. This exception is not fortuitous, but follows from the basic structure of the statute, which distinguishes passive income (interest, dividends, rents and royalties) from active business income. In administering the statute, the Internal Revenue Service can scrutinize arrangements entered into by an exempt organization in light of well-established general principles of the tax law, to determine whether the income generated through such arrangements is, in fact, active or passive income.

There are a number of rulings and cases dealing specifically with the issue of royalty income, which provide a basis to distinguish true passive royalty income from active business income. If an exempt organization actively participates, for example, in the commercial marketing of a product as to which it has a "royalty" contract, its income would be characterized by the Internal Revenue Service as income from participation in a joint venture, subject to the unrelated business income tax if the purpose of the venture is unrelated to exempt purposes. Present law thus already provides an adequate basis to ensure that the royalty exception is relied on only for truly passive royalty income. So long as income is passive rather than active, it should not be subject to the tax, and a change in the law which breaches this traditional line is a matter of serious concern.

One of the reasons, of course, for the long-standing exemption for passive income is that such income is very unlikely to create problems of unfair competition. With royalty income, in fact, an incentive for passive licensing arrangements is very much in the interest of taxable businesses. By definition a licensing arrangement encourages the commercial development, by taxable businesses, of products which use or depend on some educational asset which would otherwise be unavailable. The exempt organization in such a case is not a competitor, but instead makes possible new products for business enterprises. This is certainly true in the case of the licensing by the Smithsonian of rights to reproduce items in its collections, or rights to use the educational resources of the Institution in income-generating projects.

So long as the Internal Revenue Service has the administrative ability, which it clearly has, to see that the royalty exception is limited to the class of transactions for which it was intended, elimination of the royalty exception would be not only needless but truly counter-productive.

Allocation Rules

The discussion options suggest that deductions should be allowed in computing unrelated business taxable income for a pro-rata share of direct costs of the unrelated activity, but not for any part of the organization's overhead expenses or for depreciation. It is not clear whether this proposal is strictly limited to physical facilities used in both exempt and unrelated activities, or whether it is intended to be applied more broadly.

This proposal appears to be a response to an Internal Revenue Service concern that some organizations may have been allocating a disproportionate share of overhead costs to unrelated activities. If so, however, it is an extreme solution to what should be simply a tax accounting problem, of the kind which regulations or other administrative action could remedy. If the Internal Revenue Service concludes that some organizations are not correctly calculating their net or taxable income, more precise allocation rules should be published, just as administrative rules have traditionally governed the deduction of business expenses for purposes of the regular corporate tax.

A change of this kind in the normally applicable deduction rules would result in taxation of unrelated business activities at a much higher effective rate than comparable commercial businesses. Such a result would contravene a basic principle of the unrelated business income tax -- that exempt organizations carrying on unrelated businesses should be taxed on the same basis as comparable commercial entities.

"Regularly Carried On" Test

The discussion options propose repeal of the "regularly carried on" test, but indicate that income from an activity that is not a trade or business would remain tax-free. Examples provided in the Subcommittee's description document suggest that the Subcommittee intends to preserve the exemption from tax for some but not all forms of fund-raising events. For example, exemption would be allowed for annual fund-raising galas but not for annual fund-raising circuses. The distinction, which is not at all self-evident, would apparently be made by reference to the trade or business test.

The trade or business test is applied in the tax law for a variety of different purposes, not always consistently. It is simply not precise enough to allow for fine distinctions, and without the "regularly carried on" test the historic reliance of exempt organizations on periodic fund-raising events could be jeopardized. Whatever benefits might arise from elimination of the "regularly carried on" test -- and there have not been indications of real abuse in this area -- such benefits would not appear to be worth the cost of undermining a long-established tradition of fund-raising within the exempt community, from which museums in particular have benefited.

Advertising Income

The discussion options would tax all advertising income, and limit deductions to direct advertising costs. This change in the deduction rules is quite significant. Present law provides that if an exempt organization's publication as a whole is operated at a loss (because readership costs exceed readership income), tax should not be imposed on advertising income in excess of direct advertising costs. The purpose of this rule is to equalize the treatment of exempt organization publications and commercial publications, since a commercial magazine does not pay tax on advertising income if it operates at an overall loss. This seems to be a fair rule, which is consistent with the principle of the unrelated business income tax that unrelated business activities and commercial businesses should be taxed on the same basis. Like the broader proposals for changes in the deductibility of overhead costs, this proposal would subject tax-exempt organizations to rules more stringent than those applicable to comparable for-profit entities.

Society for the Performing Arts

Jesse H. Jones Hall • 615 Louisiana • Houston, Texas 77002-2796 • (713) 227-5134

[illegible] J. Mize* Chair
[illegible] President
[illegible] Jr.* Founder
[illegible] Secretary
[illegible] Treasurer

[illegible]
[illegible] Vedlinger

[illegible]
[illegible] Jr.
[illegible] Barnhart
[illegible] Mahon*
Joseph [illegible] Jr.*
Mrs. [illegible]witz*
[illegible]

[illegible] Amatangelo
[illegible] Butler Jr.
Mrs. [illegible] Dannenbaum
[illegible] Jr.
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[illegible] Frankel
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[illegible]
[illegible] Harrell
[illegible]
Wolf [illegible]
Harold S. Hook
James P. Houstoun, III
Richard B. Jatte
Susan P. Jetters
Barry N. Jettres
Allen N. Jones
Diana Marshall Joor
Don D. Jordan
Jake Kamin
Barbara Kauffman
Karl Laurence Kilian
Richard D. Kinder
David J. Kirkpatrick
R. Bruce LaBoon
Jack Lapin
Rodney H. Margolis
Larry J. Mathis
Donald R. McCrory
Dr. Walter [illegible] Meier Jr.
Dr. Earl Douglas Mitchell
George P. Mitchell
Robert A. Mosbacher, Jr.
Lila B. Nicolaevsky
Kenneth J. Otto
Mrs. Alvin M. Owsley, Jr.
P. Dexter Peacock
Lynette C. Proler
Harry M. Reasoner
Jerri Ready
Charles Sapp
Eddy C. Scurlock
James M. Shatto
Robert R. Shelton
Sidney L. Shlenker
Jack L. Stoner
F. Gregg Wallace, Jr.
John H. Young

*past president

[illegible] Mattox

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

The deliberations of the House Ways and Means Subcommittee on Oversight regarding unrelated business income tax on certain activities of non-profit organizations is of great concern to me. Several of the areas under consideration should not be considered "unrelated."

For example:

- On-premise gift shop sales. These are usually posters, catalogs, souvenir brochures, tee-shirts that are for the purpose of promoting the very classical artists that we present as part of the mission of the organization;

- Off-premise sales, such as phone-order sales. Most of the major non-profit arts organizations use telemarketing techniques to sell season subscriptions, single events, and to solicit maintenance contributions. All this activity is directly related to the mission of the non-profit organization;

- Advertising in programs for performances and other publications. Again, this practice of having advertising in the programs is to pay for the cost of printing the programs, a requirement by contract with each artist, orchestra, dance company, etc.;

- Mail list exchanges. It is common practice in Houston for the major presenting and producing organizations to exchange mailing lists of people who purchase tickets to our performances. No money changes hands; we bear the cost to aid each other. This practice is an attempt to further reach our separate audiences for the presentation of classical artists.

If my organization were to enter into an ownership arrangement for, say, a restaurant, then we should be subject to unrelated business income taxes. However, none of the above-mentioned was for the purpose of generating unrelated business income.

A non-profit corporation • Member, International Society of Performing Arts Administrators

I urge you and your committee to carefully study and determine the difference between unrelated business income and the efforts to generate sorely-needed income, as it directly relates to non-profit presentation of the classical arts.

If you need more information, please let me know.

Sincerely,

Hoyt T. Mattox

Hoyt T. (Toby) Mattox
Executive Director

HTM:wi

SOCIETY *of the* NATIONAL SHRINE *of the* BILL *of* RIGHTS
at SAINT PAUL'S CHURCH, EASTCHESTER, Inc.
897 SOUTH COLUMBUS AVENUE, MOUNT VERNON, NEW YORK 10550
(914) 667-4116

April 12, 1988

The Honorable Joseph J. DioGuardi
Member of Congress - 20th District
One North Broadway
Suite 901
White Plains, NY 10605

RE: Public Comment
on House Ways and Means Oversight Subcommittee
Discussion Options
For Changing The Unrelated Business Income Tax
and the taxation of non-profits' revenue-producing activities

Dear Congressman DioGuardi:

Members of our non profit organization have recently learned of the above-mentioned topic.

We are horrified to think that Congress would consider taxing the revenue-producing activities of non-profit organizations.

First, Congress made cuts in federal funding to museums in the arts and humanities. Next, Congress limited tax advantages to individuals, corporations and foundations who support these institutions. It seemed like much of this was good. It served to help make non-profit organizations more business-like, more efficient and more creative in our revenue-producing activities.

ENOUGH IS ENOUGH.

Now Congress is considering taxing the revenue-producing activities that you encouraged us to develop. You encouraged us to become more business-like and we did, TO A POINT. Though museums can be business-like, museums are not and never should become businesses. The people of this country have come to expect the right to learn about the rich art and history of our nation at minimal or low cost. If Congress enacts these discussion options into law, it will only serve to limit the availability of museums to people of all economic levels.

Please DO NOT SUPPORT the discussion options and encourage your colleagues in Congress to do the same.

Sincerely,

Connie M. Cullen

Connie M. Cullen
Administrator

CMC/jh

cc: Mr. Robert J. Leonard, Chief Counsel, Committee on Ways & Means, U.S. House of Representatives

SONOMA
COUNTY
MUSEUM

425 SEVENTH STREET
SANTA ROSA, CA 95401
707•579-1500

April 11, 1988

The Honorable J.J. Pickle (D-Texas), Chairman
Subcommittee on Oversight
Committee of Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

In regarding your Subcommittee's review of the issue involving taxation of non-profits' revenue-producing activities, I wish to respond by noting that the Sonoma County Museum is a new (opened in 1985) and struggling small regional museum, hoping to improve the quality of life for local citizens, schoolchildren and visitors alike.

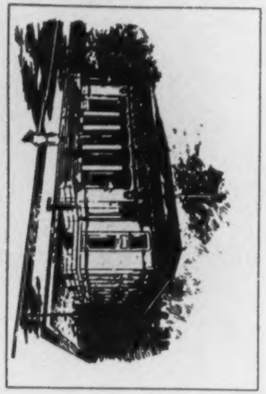
Our Museum derives its funding from private donations of dues, admissions, fundraising events, gift shop sales and programs such as our travel/study tours. These activities may appear to fall outside the immediate purpose of museums to collect, preserve and display--however, without these sources of income, the Museum would not be able to remain open to more than 400,000 citizens who live within our service area. Thousands of children would not be able to visit at no charge. These children would also not enjoy the benefit of our school outreach programs. The entire community and surrounding environs would be able to enjoy this important resource for culture, the arts and history.

We urge you and your Subcommittee members to consider retaining the opportunities available to nonprofits in order to ensure the quality of life in local communities throughout the nation. Thank you very much for your assistance in accomplishing these worthwhile goals of nonprofits.

Yours sincerely,

John Z. Lofgren
Executive Director

JZL:so
Encl.



SONOMA COUNTY MUSEUM
425 Seventh Street
Santa Rosa, CA 95401

BULK RATE
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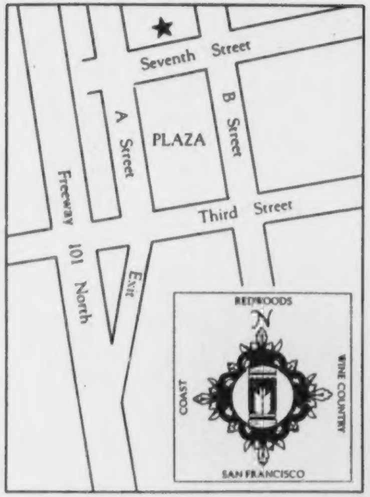
SANTA ROSA, CA

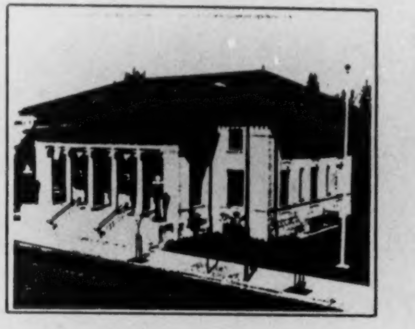
NON-PROFIT ORGANIZATION


Seventh Street
B Street
PLAZA
A Street
Third Street
Freeway 101 North
Exit
REDWOODS
WINE COUNTRY
SAN FRANCISCO
COAST
N

Open Wednesday through Sunday
11 am to 4 pm
Free to members
Admission charged

SONOMA COUNTY MUSEUM
425 Seventh Street
Santa Rosa, CA 95401
(707) 579-1500

SONOMA COUNTY MUSEUM



S A N T A R O S A

C A L I F O R N I A

What You Will Find. . .

The Sonoma County Museum welcomes you to an exciting new experience—a cultural, historical and educational showplace!

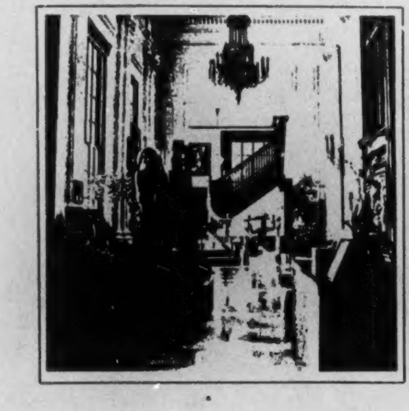
The Museum is a lively, multi-cultural resource, appealing to all ages. Rich variety and imagination will entice you to visit often.

Special programs and guided gallery tours encourage school children and adults alike to broaden their understanding and pride in our local heritage.

Learn from noteworthy exhibits, focusing on regional history and culture. And contemplate renowned works of art, including the Museum's fine collection of 19th century paintings.

Marvel in the building itself! Stand in the impressive foyer and admire the magnificent beauty of oak and marble.

The Museum, housed in the 1910 Old Post Office and Federal Building, was moved and restored 1979-1984, and is designated on the National Register of Historic Places.



What You Will Gain. . .

Be a part of this exciting experience. Preserve our grand heritage. Enrich the future for generations to come.

Join the Museum now and enjoy these benefits:

☐ Free admission to the Museum and its changing exhibits
☐ Free subscription to *Recollections*, the Museum's newsletter, which will keep you informed
☐ Invitations to receptions and exhibit previews
☐ Discounts in *The Wild Oat*, the Museum's gift shop, which features books, historical specialties and unique gifts
☐ Reduced admission to special events, such as educational programs, exclusive tours and social activities
☐ Access to the Museum's Blood Bank of the Redwoods account
☐ Honored recognition upon joining the Benefactors' Circle
☐ Charitable tax deduction for donations, trusts, gifts and bequests
☐ A chance to actively participate and ensure the future of history!

Your Invitation to Join. . .

Name____________________

Street____________________

City ____________________

State ____________________

Zip ____________________

Phone ____________________

____

☐ New Membership ☐ Annual Renewal

☐ Gift from: ____________________

☐	$10	Student (Remit I.D.)
☐	$15	Individual
☐	$20	Family
☐	$25	Contributing
☐	$50	Sustaining
☐	$100	Supporting
☐	$250	Patron
☐	$500	Sponsor
☐	$1000	Benefactors' Circle

Please make checks payable to Sonoma County Museum and mail to 425 Seventh Street, Santa Rosa, CA 95401. All dues and contributions benefit the Museum, a private, non-profit institution and are tax deductible to the extent allowed by law. Thank you for your support!

SOUTHERN FOREST PRODUCTS ASSOCIATION
POST OFFICE BOX 52468 • NEW ORLEANS, LA 70152 • TELEPHONE (504) 443-4464 • TELEX 758854

April 14, 1988

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Congressman Pickle:

The Southern Forest Products Association is a 501 (c) (6) trade organization formed in 1914, which represents Southern Pine lumber manufacturers from East Texas to Virginia. In 1987 our industry produced 12.46 billion board feet of Southern Pine lumber with approximately 260,000 employees, and an annual payroll of 2.5 billion dollars. The value added by manufacturing is estimated to be 6.1 billion dollars.

In addition to the market development and governmental affairs programs we provide our membership, we also plan and conduct a biennial machinery exposition for the Southern Pine lumber industry. The stated objective of this trade show is to provide our industry with the opportunity to review the latest technology in sawmill machinery and logging equipment. The income generated from space sales is used to pay the show costs, and any profits generated are applied to the initial costs of the next exposition and to support our marketing program.

We are opposed to any change regarding established provisions which apply to trade shows that directly relate to the industry's primary interest. The taxing of this income would result in increased membership dues or the reduction of our current program.

We encourage you to maintain the current provisions of industry trade shows.

Sincerely,

SOUTHERN FOREST PRODUCTS ASSOCIATION

KARL W. LINDBERG
President
KWL:ccm

April 15, 1988

THE SPORTS CONNECTION

Honorable J.J. Pickle
Chairman Subcommittee on Oversight
Washington, D.C.

Dear Sir:

As an independent recreational club owner, and working not on the behalf of any trade association to which I might belong, I would like to submit the following proposal for your UBIT committee's consideration.

"Apply UBIT to all income from individuals using recreational or fitness facilities or activities if the average of their annual adjusted income exceeds the current national average of adjusted income". The acceptance of this proposal would be conditional on the passage of the following.

"Charitable organizations must maintain the proper ratio of UBIT income to related income in all their independent areas or locations of operation".

The above proposal would accomplish the following.

1. It would maintain existing charitable/recreational activities or facilities in areas where the majority of use is already by those receiving under national average adjusted income, such as some rural and inner city areas.

2. It would open up memberships currently being held by upwardly mobile type individuals for usage by individuals whose income is below the national average income; while allowing those facilities to maintain a good percentage of affluent users, providing UBIT is properly paid.

3. It would allow the continued existance of the so called "sliding scale policy". While this policy is a direct "destination of income" UBIT violation, this new proposal would not prohibit its existance. UBIT would be assessed to those persons in the above national average income category, who contribute to the sliding scale.

4. This policy would insure that future recreational/fitness type clubs would be built closer to those who most need charitable help. The current "affordability policy" has encouraged charities to build in "affordable" communities which might not be easily accessible to those who have financial difficulty. In order to maintain the required ratio of UBIT vs related income, in each facility, charities would most likely locate in areas where they are more accessible to those who need charitable services.

5. The offerring of second tiered memberships, i.e., Gold Clubs, constitutes "destination of income" where certain areas of a nonprofit charity are profit oriented. The second clause of my proposal would state that "related" use must match "unrelated" use in these areas in order to maintain current tax exemption. It would not prohibit these restricted areas from being reclassified as 501(C) 7 organizations if so desired.

6. This proposal would put the burden on the charity to cater not to what the "community" can afford, but to what "middle America" can afford to pay.

7. Monitoring UBIT would be necessary. While this might require additional tracking of use and income, the YMCA, has been using a type of tracking in its hotel operation. A similar situation occurs where a high percentage of hotel users is required to be charitable classified individuals. Furthermore, most charities, such as the YMCA, have been able to provide the United Way with such a breakdown. My suggestion is that the YMCA mention on their membership application that an additional discount is available to those whose income falls short of the national average. This discount could be tied to each individual providing the YMCA with federal income tax reports. This would not constitute a change of policy as currently the YMCA's suggested policy for scholarship memberships is to review the applicant's income tax report.

All the non-UBIT fee players to a fitness club must be registered by name and social security number so that periodic checks could be made by the IRS. Upon the reviewing of the returns, one should see in each facility a proper ratio of taxable income to total income. Penalty fees could be assessed if violations were discovered. The type of information listed above is already required for general membership in the YMCA.

8. While a stiffer policy is truly warranted, I believe my proposed policy would meet with the acceptance for the following reasons. A. Most of the criticism is by owners who see the new facilities catering to over 85% of the people whose income is above the national average. This proposal would force a reduction of that percentage thus freeing up members to join commercial clubs. B. Tax dollars would not be used to build over priced facilities instead of providing only the basic services that are needed. C. Commercial operators cater primarily to individuals who receive over the national average of income. The charitable operator, to fill the under national income category, would be encouraged to price accordingly. In turn, this would probably be offset by higher rates for those who fall into the UBIT category thus making it fairer for a commercial operator to compete economically for those customers.

9. In so much that this proposal is tied to an easily accessible but variable national indicator, it would self adjust for economic changes in our economy.

I feel this is a fair compromise which could possibly be acceptable to those on both sides of the issue. More importantly I think it meets the needs of the nation by directly assessing those who can afford to pay tax while satisfying the physical fitness needs of those who are in need of financial assistance.

I submit this with hope that you'll correct some of the injustices that currently face our commercial recreation industry. Should your committee agree to this proposal as an acceptable compromise, I will use my influence and energy to convince the members of my trade association, IRSA, to support it.

Yours truly,

Mike Talla
Sports Connection
1900 South Sepulveda Blvd
Los Angeles, CA 90025-5620

RESOURCE FOR OUR FUTURE
THE CAMPAIGN FOR ENDURING EXCELLENCE
Art Center
513•325•4673
PATRICIA D'ARCY CATRON • DIRECTOR
107 CLIFF PARK ROAD SPRINGFIELD OHIO 45501

April 10, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington D.C. 20515

Dear Congressman Pickle,

As the Assistant Director of a small Art Center and Museum, I feel compelled to write and protest the Subcommittee's preliminary discussion options regarding the Unrelated Business Income Tax (UBIT) as they affect small non-profit organizations.

I am especially concerned with the application of the "directly related test" as it applies to gift shop income, and travel and tour services. As the only visual arts organization in a relatively small community, trips planned by our Center are often the only means of cultural travel afforded to community members, and therefore one of the only organized methods of enhancing their art education. As profit from these trips is negligible, and secondary to their educational merit, a tax on such tours would only serve to end this type of programming.

To place an increased tax burden on small non-profit organizations would be life-threatening to many fine cultural organizations in this country. It is my most sincere hope that the Subcommittee will reassess its position on the UBIT options and realize the harmful impact their enactment would have on our country's museums.

Sincerely Yours,

Christine A. Myers

Christine A. Myers
Assistant Director
Springfield Art Center

FORTY YEARS OLD, CENTURIES TO GO!

St. EDWARD'S
UNIVERSITY
AUSTIN • TEXAS

Office of the President

April 15, 1988

The Honorable J. J. Pickle
Chairman, The Committee on Ways and Means
  Oversight Subcommittee
242 Canon House Office Building
Washington, DC 20015

Dear Jake,

I am writing in response to your invitation to submit comments on the Oversight Subcommittee's options for ways to revise the unrelated business income tax (UBIT). I have not previously been in contact with you about this issue because St. Edward's activities which generate income are minimal and do not fall into categories with which the small business community has expressed concerns.

However, when I received the April 3 options paper, I became quite concerned. The paper suggests revisions to UBIT which go far beyond charges of unfair competition and which could affect directly some of the important aspects of the educational and campus life activities at St. Edward's University. Although very little revenue is involved, St. Edward's would be involved in expensive record-keeping. The options are also of a nature that involves fundamental issues of tax exemption and charitable activities. I am, therefore, taking the liberty of sending my comments directly to you and to your subcommittee staff.

Elimination of the Convenience Exception

Of greatest concern to St. Edward's is the proposed elimination of the "convenience exception." One of the key reasons that this exception was included in the Tax Code was to ensure that colleges and universities did not have to argue with Internal Revenue Service auditors over whether each dormitory and each food service facility was related enough to purposes of education to qualify for exclusion. It was recognized that absent such an exemption, an auditor would be required to scrutinize each activity and could well decide that some of these activities did not meet the relatedness test. In such cases, campuses would be faced with the expenses of challenging such a determination.

A residential campus like St. Edward's provides a number of services for students and faculty which are presently non-taxed under the convenience exception such as parking, medical services, laundry facilities, vending machines, pay telephones, and copying facilities. Clearly we do not undertake these activities to make money nor is there much income which would possibly be taxed. To eliminate the convenience exception in its entirety would nonetheless cause us to establish accounting and tracing processes and employ people to account and track such mundane services.

I would urge you to either retain the convenience exception (even in a scaled-back form) or directly specify that ordinary campus services are excluded from UBIT.

Advertising Income

I have similar concerns about the proposal to subject to UBIT--regardless of connections to our educational activities--income derived from advertising. At St. Edward's University, the two primary users of advertising and advertising income are our campus newspaper, Hilltopics, and our small sports program. In addition, some student activities connected to the University may occasionally use advertising as a way of supporting their projects.

In each case, both the inclusion of advertising in the definition of UBIT and the changes in the ways of allocating our program expenses, to which these ads are directly linked, would cause the generation of very small amounts of taxable income. It is very hard for me to see how such a proposal improves in any way the tax policies behind UBIT. What it would mean, again, for St. Edward's is the need to allocate precious staff time to tracing and accounting for these meager funds.

Off-Premise Sales

Finally, I am troubled by the proposal to subject to UBIT any sales of books or educational materials if the sales are made off the campus. This proposal would cause us to pay UBIT on the books and materials our faculty sell to students enrolled in our off-campus classes. Presently our faculty go directy to IBM and Texas Instruments to conduct courses for their employees on the corporate premises. So that they will not have to travel to our campus just to buy a course book, we sell the items to them there. According to this proposal, those sales would be taxable as UBIT.

In each of these cases, St. Edward's is merely carrying out our educational activities through means which are not driven by taxes or tax planning. I am greatly concerned that proposals such as these infuse these educational activities and the process of serving students with unnecessary tax implications. It discourages the provision of good quality and attentive education.

I know of your concern for education and appreciate your willingness to consider carefully the implications behind such complex tax proposals. As always, I am willing to speak further with you or to speak with your staff who are struggling through this morass. Please do not hesitate to call on me in any way in which I could be helpful.

Sincerely,

Patricia Hayes

Patricia A. Hayes
President

PAH:cej

cc: Robert Leonard

1872

ST. ELIZABETH'S HOSPITAL OF BOSTON
736 Cambridge Street, Boston, Massachusetts 02135 (617) 789-3000

COMMENTS FOR THE SUBCOMMITTEE ON OVERSIGHT REGARDING THE UNRELATED BUSINESS INCOME TAX

I am William J. Skerry, President of St. Elizabeth's Hospital of Boston, a section 501 (c)(3) corporation. I wish to thank you for the opportunity to comment on the preliminary discussion options regarding the unrelated business income tax, which were recently released by the Subcommitee on Oversight.

St. Elizabeth's Hospital is a 350-bed, full service hospital located in the central city of a large metropolitan area. We are a major teaching hospital of Tufts University School of Medicine and we operate a diploma school of nursing. We have a large proportion of Medicare patients and operate in a highly regulated state environment.

Historical Perspective

Under the "substantially related" standard and the "convenience" exception, the law has long given tax-exempt hospitals the opportunity to generate non-taxable income from related business with patients, visitors, employees and other associates. Other provisions of the law also traditionally allow hospitals to generate similar non-taxable income. This income was traditionally used to augment limited income levels from hospital operations so as to better provide community service.

More recently, hospitals have been subjected to massive reductions in Medicare funding and, in a number of states, to similarly severe reductions in reimbursement levels of other purchasers of patient care services. In order to continue to provide services which the community expects and demands, hospitals have been forced to turn to other sources of non-taxable income. This has affected some for profit businesses, and particularly small businesses. The resulting controversy is understandable and the issues are complex.

General Comments on the Issue

I ask that the Subcommittee work under the general principle that income which traditionally has been treated under the law as non-taxable to tax-exempt hospitals not be changed at this time. I think that it would be particularly inappropriate to make such changes now when hospitals are facing annual Medicare deficits and are being buffeted by numerous other economic and financial issues.

I also think that the Subcommittee should be cautious about recommending tax law revisions which would have the effect of moving patient care services, which have traditionally been provided by hospitals, to business enterprises. There are quality controls which have long been in place in hospitals but which one might not find in other arenas. The surveys of the Joint Commission on Accreditation of Healthcare Organizations and more stringent licensing requirements which one finds in hospitals are examples of such controls. Recent stories about lapses in laboratory testing point to the need for quality to be given a very high priority.

I feel that there is some need for further delineation of the relative roles of small businesses and tax-exempt hospitals in certain endeavors. This consideration would be important in looking at those kinds of endeavors into which hospitals, under pressure of decreasing income from patient care, have recently felt it necessary to venture. This is not however a justification for an extensive overturning of long-established tax law and regulation under which hospitals have long been given UBIT exemption.

Specific Issues

I should like to address some specific issues of concern to me. This is not an exhaustive list but is intended to highlight those discussion options which are most important to us.

1. Gift Shops St. Elizabeth's for many decades has had a gift shop for the use and benefit of patients, visitors, employees and others associated with the Hospital. The shop is operated by the Hospital's Auxiliary and is one of the major sources of revenue to the Auxiliary. The Auxiliary in turn provides a major non-patient revenue resource to the Hospital. To exempt only low-cost mementos and inpatient-use items from UBIT represents a major departure from a long-standing tax law policy and adds a significant administrative, not to mention financial, burden to the Hospital Auxiliary.

2. Medical equipment and devices, laboratory testing, and pharmaceuticals Again, there is long-established precedent for exemption from UBIT. Many of these activities are most certainly substantially related to the hospital's tax-exempt purpose. In addition, there are operational subtleties in these activities which do not seem to be expressed in this option. For example, a respiratory home care program, which involves medical equipment, also has a significant service component and an important quality consideration. The language of the option seems to indicate that income which we derive from services in connection with such a program - services we furnish because of the quality controls which we

provide - would, under the option, be subject to UBIT. There would be similar potential problems with such programs as home dialysis (depending on how outpatient continuous care is defined) and intravenous home therapy. Even more off the mark is the suggestion that services provided to outpatients (other than continuous care or emergency patients) are not directly related to the tax-exempt purpose. The implication seems to be that, in order to avoid a UBIT situation, such a patient being treated in a teaching hospital's clinics should be referred out of the hospital for laboratory testing and then return for completion of the diagnosis and treatment. Not only would this be a gross inconvenience to the patient but it would represent a deleterious intrusion into the physician training process.

I strongly urge you to reconsider your approach to this option.

3. Allocation rules The federal government has a long history of precise total cost determination for purposes of reimbursing tax-exempt organizations. Examples of this are cost based reimbursement for Medicare services (which is still in effect for outpatient services and inpatient excluded units) and for National Institutes of Health medical research indirect costs. The proposed exclusion of general overhead and depreciation from expenses is inconsistent with these reimbursement policies and current tax practice and should be reconsidered.

4. Piecemeal exclusions of certain activities Present law excludes from UBIT the income from services rendered to small tax-exempt hospitals. This provision is an encouragement - as it should be - to small hospitals to purchase services from other hospitals, particularly nearby hospitals, rather than to furnish these services themselves. This has the benefit of making hospitals more cost effective, a goal which the federal government obviously strongly supports.

We are in fact presently considering the relocation of a smaller hospital to our campus. Within the context of that hospital's retaining its own identity, there are a number of benefits to such a move, among which are: a smaller physical plant for the other hospital; better utilization of the plant of both hospitals; improved backup services for the other hospital; sharing of services; and better utilization of land. One of the keys to the success of this venture is our ability to sell certain services to the other hospital under a financially feasible arrangement. The proposed UBIT change regarding sales to other hospitals would jeopardize this arrangement.

Further UBIT restrictions on services to other hospitals and on cooperative service arrangements do not help hospitals to reach this goal of cost effectiveness. They are instead counterproductive because the operating cost, including UBIT, to the two hospitals (as a case in point) would increase rather than be reduced. Actually, UBIT regulations in this area should be liberalized and the present size restriction on hospitals to which UBIT exempt sales are made should be increased.

I appreciate your consideration of these comments on the UBIT options.

ST. LAWRENCE COUNTY
HISTORICAL
ASSOCIATION
3 EAST MAIN STREET / P.O. BOX 8 / CANTON, NEW YORK 13617 / (315) 386-8133

April 12, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

Dear Mr. Leonard:

As director of a small county history museum and research center I must express grave concern over the implications of the preliminary discussion options regarding the unrelated business income tax. We generate income which is absolutely essential to the maintenance of our museum, and the continuation of our educational programs, by selling calendars, greeting cards and other materials produced by our association, and by running occasional bus tours to places of historic and cultural interest.

It appears that activites of the first kind might be affected by discussion option I,A, while our bus tours would definetly be affected by discussion option I,D. We are not in competition with private tax paying businesses in either case, and we desperately need the revenue which these activities provide. The impacts of repealing the "substantially related" test and replacing it with a "directly related" test, or repealing the "regularly carried on" test could be even more far reaching and disastrous.

The effect of the discussion options generally, should they be enacted into law, would be to severely curtail the locally created educational programs of very small museums such as ours, which are usually poorly endowed and which often serve relatively isolated and impoverished populations, while further restricting our access to expensive traveling exhibits and prestigious interpreters of our nation's and region's cultural heritage.

Sincerely,

Garrett Cook

COMMENTS OF
JOHN A. BURDINE, M.D., PRESIDENT
ST. LUKE'S EPISCOPAL HOSPITAL
HOUSTON, TEXAS
ON THE
UNRELATED TRADE OR BUSINESS INCOME TAX PROPOSALS

April 15, 1988

The Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives (the "Subcommittee") has solicited comments from the public with respect to various options to be considered in connection with possible revisions to the current unrelated business income tax ("UBIT") provisions of the Internal Revenue Code of 1986. Those options, which were outlined in a press release dated March 31, 1988, are a follow-up to the hearings held by the Subcommittee last summer. St. Luke's Episcopal Hospital, Houston, Texas ("St. Luke's Hospital"), hereby respectfully submits comments on certain of the options presented in the press release.

St. Luke's Hospital is one of the leading tertiary-care hospitals in the southwestern United States and together with its affiliated tax-exempt organizations is recognized world-wide as a leader in cardiovascular care. St. Luke's Hospital is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986 (hereinafter all section references are to the Code) and is other than a private foundation within the meaning of section 509(a)(1) as a result of being described in section 170(b)(1)(A)(iii).

Prior to specifically addressing the proposals set forth in the press release, it is informative to examine the background of the current controversy. Last summer, in response to allegations of unfair competition from various quarters, the Subcommittee held hearings to examine whether revisions to the existing UBIT structure were necessary. A common theme of those hearings was that sufficient information on which to base any meaningful modifications to the existing UBIT structure was not available. 1/ Thus, the hearings closed without any demonstrative evidence being presented that the allegations of unfair competition by exempt organizations were anything other than just that--allegations.

Now, additional hearings are being held to consider specific revisions to the UBIT structure despite the fact that information regarding the effectiveness of the current rules still has not been compiled. St. Luke's Hospital believes that the comments made last summer before the Subcommittee by the Honorable O. Donaldson Chapoton, Deputy Assistant Secretary (Tax Policy), Department of the

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1/ *See* Statement of O. Donaldson Chapoton, Deputy Assistant Secretary (Tax Policy), Department of the Treasury, before the Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives (June 22, 1987) (hereinafter cited as "Treasury Statement") p. 3.

Treasury, to the effect that legislation would be premature to be equally applicable today. 2/ Moreover, St. Luke's Hospital is concerned that without meaningful information regarding the operation of the current structure, changes will be made to the existing UBIT rules to correct the isolated abuses alleged last summer in such a way that many currently legitimate activities undertaken by exempt organizations will be precluded. To deny those activities to tax-exempt entities, and in particular, tax-exempt hospitals, at a time when alternate revenue sources are essential to offset rising costs and declining revenues, particularly declining Medicare and Medicaid program revenues, appears to be as unfair to tax-exempt organizations as the alleged abuses are to taxable businesses.

As the Subcommittee is aware, a taxpayer compliance maintenance program ("TCMP") is currently being conducted by the Internal Revenue Service (the "IRS"). The TCMP is designed to gather additional information regarding the effectiveness of the current UBIT provisions. St. Luke's Hospital respectfully urges the Subcommittee to delay any action modifying the UBIT provisions until the results of the TCMP can be incorporated therein.

I. THE "SUBSTANTIALLY RELATED" TEST

In general, income derived from activities which are "substantially related" to the charitable purpose or purposes of an exempt organization are not subject to UBIT. The three alternatives to the "substantially related" test set forth in the press release are: (A) replace the "substantially related" test with a "directly related test," (B) require a determination whether each income-producing activity standing alone is tax-exempt or (C) retain the "substantially related" test, but tax the income derived from specific activities deemed inherently commercial.

A. "Directly Related" Test

Although it is not clear from the press release, it is assumed that the "directly related" test will require a greater degree of relationship than the "substantially related" test. It is also not clear whether a "directly related" test will afford any more certainty or fairness than the "substantially related" test as either test will depend upon subjective factors. The current "substantially related" test may not be perfect, but it has proved to be relatively effective; that is, exempt organizations engaging in businesses which are not part of and related to such organizations' exempt activities must pay a tax on the net income derived from such businesses under the "substantially related" test. Therefore, the confusion and uncertainty resulting from a change to a "directly related" test, the parameters of which are as yet unknown, would appear to far outweigh any perceived benefit, especially when the perceived benefit in all likelihood would be based on speculation as opposed to meaningful statistical data.

2/ Id.

B. Stand Alone Analysis

The second alternative to the present "substantially related" test is an individual analysis of each income producing activity conducted by an exempt organization to see if each such activity, standing alone, is tax-exempt. This stand alone test would represent a drastic departure from current law and would severely reduce the revenues otherwise available to exempt organizations to be used in the conduct of their exempt purposes.

The undesirable effect of the stand alone test in the health care area is clearly illustrated by a hospital's patient, employee and visitor support activities, such as parking, gift shops and cafeterias. 3/ These activities are an important part of the efficient provision of quality health care (both on a direct and indirect basis) by a hospital; however, each of those activities is not tax-exempt when viewed standing alone. Similarly, other activities which are usually viewed as exempt may not be so viewed when analyzed under the stand alone test. For example, the class of beneficiaries being served with respect to some currently exempt activities may be deemed to be too small for such activity to be viewed as "charitable" when viewed on its own. Thus, the stand alone test would result in the taxation of revenue which is currently available to support (1) non-revenue producing exempt activities, (2) the below cost or gratuitous provision of health care services and (3) most importantly, the provision of quality health care.

The traditional patient, employee and visitor support activities which would become subject to tax under a stand alone analysis are most effectively provided on an on-premises basis by the health care institutions involved. As such, the stand alone test's reduction in the support of charitable health care activities will not be accompanied by a corresponding benefit, such as enhanced competition for commercial enterprises, because the activities involved are of a type which cannot be provided in a manner or volume which would be conducive to commercial activities. Also, if changes to the present UBIT provisions are motivated by the desire to force the conduct by commercial enterprises of those ancillary activities presently being conducted by exempt organizations, the changes could cause loss of control (quality and otherwise) by exempt organizations of activities related to the accomplishment of such organizations' charitable purposes.

Based on the foregoing discussion, it is apparent that in the health care context the stand alone test would cause a reduction in revenues which traditionally have been available to support related, charitable activities. If imposed, the stand alone test will mandate either an increase in patient charges or a reduction in health care services. In light of those negative results, it is suggested that the stand alone test be eliminated from the alternatives to the "substantially related" test being considered.

3/ These activities are also discussed under the "Convenience Exception," *infra*.

C. Tax Inherently Commercial Activities

The third proposal to modify the "substantially related test" is to tax income derived from inherently commercial activities, a list of which is contained in the press release. With respect to the list, it is hoped that the listed activities describe substantially all "inherently commercial" activities as experience suggests such lists become significantly longer prior to enactment. While we advocate retention of the "substantially related" test, we are nonetheless concerned over the use of seemingly inexhaustable list of "inherently commercial" activities which materially alters the "substantially related" concept.

Turning to the listed "inherently commercial" activities, the proposal set forth in the press release to subject revenues derived from gift shops to UBIT unless the articles sold are used by or for inpatients is both inequitable and unworkable. Without demanding some sort of identification, a salesperson will have no way of knowing whether a purchase is being made by or for an inpatient. It is similarly impossible for an all inclusive list of "approved" articles required by inpatients to be developed. Thus, to impose an inpatient/outpatient UBIT test to hospital gift shops appears highly unsatisfactory, particularly in view of the fact that on-premises sales of merchandise by hospital gift shops do not appear to pose a competitive threat to any other businesses. At a time when there is an increasing trend towards, and demand for, outpatient procedures, limiting sales to inpatients does not seem proper. Under the proposal set forth in the press release, a hospital will be forced to send outpatients elsewhere for certain of their needs, unless the hospital is willing to pay additional costs and endure additional administrative burdens.

Other proposals are also troublesome. With respect to medical equipment sales or rentals, it is not clear that the suggested modification addresses only casual sales or rentals to persons who have no existing, nor develop any, patient relationship with a health care institution. In light of the problems which might be caused in the medical equipment area by enactment of the proposal set forth in the press release, an alternate approach based on the patient concept already adopted by the IRS is suggested. Sales and rentals of medical equipment to persons who do not fall within the patient categories defined by the IRS would be subject to UBIT while sales and rentals to patients (including inpatients, outpatients and patients enrolled in home health care programs) would not be so subject. The patient concept might also be used to address a number of other UBIT issues developing in the health care area.

The routine testing proposal also causes concern. The development of new health care procedures and/or equipment often involves repetitious activities which may be mistakenly classified as routine testing. Similarly, tests are performed on many patients, such as surgery patients, as an integral part of efficient health care delivery. Such tests are routine only in their frequency and are often not commercially available. Thus, it is suggested that any modifications to the application of UBIT to testing activities clarify that testing which accompanies patient treatment, involves medical research or is undertaken as part of medical education is neither routine nor subject to UBIT.

One final comment must be made on the concept of "inherently commercial" activities. St. Luke's Hospital, as are many hospitals, is located in a medical complex made up of many health care institutions. Often, one institution will incur the costs necessary to implement technologically advanced procedures, which are unique or are not commercially available, and offer those procedures to other institutions in the same proximity. Typically, the cost of such procedures is passed directly on to the patient. St. Luke's Hospital suggests that any list of "inherently commercial" activities be drafted in such a way that this type of resource sharing is not impeded, particularly in view of the unnecessary costs involved in duplication of such procedures.

D. Summary

As the foregoing comments suggest, St. Luke's Hospital believes that the "substantially related" test continues to be useful. Thus, any drastic revision such as the adoption of a "directly related" test or a stand alone UBIT analysis is strongly opposed. Moreover, implementation of broad, general changes in response to claims of unfair competition is also opposed. The "substantially related" test may be in need of some modification to account for specific activities, but in view of the dearth of information regarding the effectiveness of the current UBIT structure, many of the suggested modifications appear to be premature.

II. CONVENIENCE EXCEPTION

Current law provides that net income derived from activities which are carried on primarily for the convenience of, among others, patients, visitors or employees (i.e., the "convenience exception") are not subject to UBIT. Thus, revenues received from parking, gift shops, cafeterias and other support services by a hospital have not been subject to UBIT. 4/ As is discussed above under the stand alone test alternative to the "substantially related" test, imposition of UBIT on the activities just described reduces the revenues available to exempt organizations to be used in pursuit of their charitable activities. Thus, any modification to the existing convenience exception should be made only with a corresponding clarification of the "substantially related" test (or any alternative thereto) whereby it is made clear that traditional patient, employee and visitor support activities are an extremely important part of the exempt activities of health care institutions, and thus, not subject to UBIT.

III. TAX TREATMENT OF ROYALTY INCOME

4/ Although it is not clear under current law whether the proper analysis for such activities is under the "substantially related" test or the convenience exception, Assistant Secretary Chapoton has indicated that these activities are not subject to UBIT as a result of being "substantially related" to the tax-exempt organization's charitable purposes. See Treasury Statement p. 22. Nonetheless, St. Luke's Hospital feels some comment on the convenience exception is necessary.

The Code presently provides that royalty payments which are not debt-financed are not subject to UBIT. The press release describes a proposal whereby UBIT would be applied to royalties measured by net or taxable income derived from property or received for use of property if the receiving organization, or a closely-related organization, either created such property or performed substantial services or incurred substantial costs with respect to the development or marketing of such property. The suggested proposal could have broad, undesirable effects in the health care area.

New medical equipment and technology has often been developed in partnerships or joint ventures involving exempt health care institutions and, in some cases, commercial enterprises. Development costs funded by the exempt health care institutions have traditionally been recouped through royalty income received upon the successful marketing of the new device or technology. The proposal set forth in the press release might affect the ability of exempt health care institutions to recoup such development costs, which costs are often substantial.

It is believed that the imposition of taxes on the foregoing method of developing new medical technology and equipment would have a material, adverse impact on the advancement of medical knowledge and the improvement of health care quality since a significant source of recoupment of development and research costs would be eliminated or, at the very least, reduced. Recognizing that exempt health care institutions perform a major part of the medical research undertaken today, it seems ill-advised to restrict the manner in which such institutions may participate in the active development of new medical technology and equipment.

IV. SUBSIDIARIES AND JOINT VENTURES

A. Minimum Income of Taxable Subsidiaries

The proposal to require a taxable subsidiary of a tax-exempt organization to recognize income at least equal to the income which, if the income generating activity were conducted by the tax-exempt parent, would be subject to UBIT is questionable. If this proposal is designed to prevent loss generating activities from being offset against income producing activities in taxable subsidiaries of tax-exempt organizations, the proposal results in the artificial inflation of the income of a tax-exempt organization or its affiliates which will be subject to tax. Moreover, not allowing such offset by businesses owned by tax-exempt organizations but continuing to allow other businesses to so offset does not appear to "promote" competition and fairness.

B. Aggregation of Activities

Currently, the exempt status of an organization is determined solely with respect to the activities undertaken, directly or indirectly, by such organization. Thus, as a general rule, activities of a wholly-owned, for-profit subsidiary of an exempt organization are analyzed separately from the activities of the exempt parent organization unless such activities are appropriately deemed carried on, directly or indirectly, by such exempt parent organization. The press release contains a proposal which would aggregate the income and activities of a controlled subsidiary with the income and activities of its exempt parent organization for purposes of determining whether the exempt parent organization is tax-exempt, regardless of whether it is appropriate to view such activities as having been carried on, directly or indirectly, by such exempt parent organization.

The formation of a for-profit subsidiary by an exempt organization in which to place unrelated business activities is fostered by the current UBIT provisions. The subsidiary is taxed on its income from the unrelated activities and any after-tax dividends paid to the exempt parent are not subject to UBIT, unless the acquisition of the business subsidiary was debt-financed. This result is no different from an exempt organization's investing in the stock of a publicly held corporation.

The proposal set forth in the press release suggests that because of perceived abuses the separate existence of an exempt parent organization and a business subsidiary corporation, more than 50 percent of which is owned by the exempt parent organization, be ignored and the activities of the corporations be considered together in order to determine the exempt status of the parent organization. The perceived abuses sought to be corrected by the aggregation approach (i.e., the conversion of income subject to UBIT into exempt income while maintaining the deductibility of expenses incurred in the production of such income) would be better addressed by more specific proposals. For example, the proposal relating to royalty income appears to address part of the foregoing concern as does the lowering of the control threshold to 50 percent. Thus, it is suggested that enactment of the aggregation approach to determine a parent organization's exempt status is overly broad and that more narrowly focused provisions are available with which to correct perceived abuses.

V. ALLOCATION RULES

In determining unrelated trade or business taxable income, a tax-exempt organization is currently entitled to a deduction for expenses which are directly connected with the carrying on of the unrelated trade or business. Examples of the deductible costs are direct operating costs, general overhead and depreciation expenses. The press release sets forth a proposal which would disallow a deduction for general overhead and depreciation expenses.

While it can be argued that certain overhead expenses and depreciation expenses incurred by exempt organizations to support their exempt activities will be present regardless of the conduct of any unrelated trades or businesses, denying a deduction for such expenses properly allocable to an unrelated trade or business is contrary to the most basic principles relevant to the computation of income from a particular activity. In order to properly compute the income derived from a particular activity, it is necessary to consider all expenses, including overhead and depreciation. Otherwise, the income derived from the activity is overstated. While it cannot be denied that tax-exempt organizations should not be given a competitive advantage over commercial enterprises with respect to the conduct of an unrelated trade or business, it is equally clear that exempt organizations engaged in an unrelated trade or business should not be made to pay more tax than a commercial enterprise in the same situation by artificially increasing their income. To do so is to penalize an exempt organization for the conduct of charitable activities.

In conclusion, St. Luke's Hospital has serious reservations regarding any substantial modifications to the existing UBIT structure in light of the lack of meaningful data with respect to the efficiency and fairness of the existing system. Moreover, St. Luke's Hospital is also concerned that, in an attempt to correct isolated abuses, broad changes will be enacted which adversely impact traditional sources of revenue for tax-exempt health care institutions. As such, St. Luke's Hospital urges the Subcommittee to act only on the basis of meaningful data and not in reaction to a few cries of "unfair competition."

RAY STALLONS AND ASSOCIATES
506 Nebraska Street
P.O. Box 3525
Sioux City, Iowa 51102
(712) 258-3209

April 13, 1988

Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sirs:

I have just been advised that The House Ways and Means Oversight Subcommittee has released preliminary discussion options regarding reform of the Unrelated Business Income Tax (UBIT) system that applies to non-profit organizations. Hopefully, the congressional hearing held last year from small business men across our country have not fallen on deaf ears, and action will be forth coming for legislation to protect the tax paying small business from the leeching non-profit systems.

I have read the recommendations made through the congressional hearings and I encourage your committee to include all the proposed measures in the final UBIT report, especially to all hearing aid sales income of the non-profit organization.

My specific area of concern is the unfair competition of the supposedly non-profit organizations who are selling hearing aids in my area of Western Iowa and Southeastern South Dakota. Specifically, the Siouxland Easter Seal Society, The University of South Dakota at Vermillion and the Area Education Agency's school audiologists are selling hearing aids and other products and services without being taxed as a business and thus robbing the government of revenue. Is this the start of a nationalized health delivery system?!!

My business has suffered net losses and erosion of retained earnings over the past few years, due to the non-profit organization who sell at low discount prices because they don't have the overhead and tax obligation of the self employed businessman. We have also had to reduce our office staff personnel, due to the loss of revenue.

Another non-profit organization which affects our business is the University of Iowa, at Iowa City. This clinic is as highly thought of as the Mayo Clinic in Rochester, Minnesota and therefore we lose potential customers to the University of Iowa, which can be verified by our documentation.

The university's have justified themselves by stating that it is a training tool for their students. However, in all other areas of study within a university, the students don't compete with taxable businesses to learn. There are many other ways to teach these students about hearing aids. Besides, if there are no students available at the time of fitting, the clinical supervisor fits the hearing aids by themselves.

I do hope that The House Ways and Means Committee will include all of the proposed measures in the final UBIT report. The small businessmen need your support on this matter. Without it, many businesses will no longer be in business because we just can not compete against a non-profit status.

Ray Stallons
Audiologist, M.S.

Ken Stallons
Certified Hearing Aid Audiologist

Kansas City's
STARLIGHT
THEATRE

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C.   20515

RE: Press Release # 16
Subcommittee on Oversight

Dear Mr. Leonard:

We recently received...and read with great dismay... the above-captioned press release concerning the Subcommittee's discussion options concerning the unrelated business income tax. We appreciate the opportunity to offer our comments.

The Starlight Theatre Association of Kansas City, Inc. is beginning its 38th consecutive year, presenting and producing live professional musical and non-musical theatre. We are an outdoor, 7,854 seat amphitheatre located in the heart of the 1,700 acre Swope Park in Kansas City, Missouri.

As one of only two such producing outdoor theatre organizations in the country (there was once 16!), and with a valued summer tradition of 38 years in Kansas City, we take great pride in providing live, professional entertainment at affordable prices for our community and five surrounding states. While we are not self-sustaining financially, we also pride ourselves on being able to fulfill our commitment to our audiences with contributions totalling only approximately 10% of our annual two million dollar budget. These private sector contributors support our activities because they share our commitment to live, professional theatre at affordable prices.

Our revenue is produced from a number of sources, the primary one being ticket sales. Of all ticket sales (approximately 150,000 tickets totalling over 1.3 million dollars), approximately 80% are handled over the phone. Under the Subcommittee's discussion these could conceivably be termed "off-premise" sales, as could all mail-order ticket sales. If these were taxed, the loss of revenue would be devastating!

We also rely upon revenue from the sale of "novelty items" (which the Subcommittee refers to as "gift shop items"), program book advertising, mailing list exchanges and rentals/purchases, various fundraising functions during each year, low-cost "gifts" as benefits given to donors and members, facility rental, and other activities to generate revenue. The subcommittee has tentatively agreed to discuss all of these areas and consider taxing them! Again, the loss or revenue from such a decision would be devastating!

As a civic, not-for-profit 501 (c) (3) corporation ...and as you know...revenues from any sources do not benefit any person. If we are fortunate enough to enjoy revenues in excess of expenses, which has not occurred in recent memory, those revenues would be used for capital improvements, programming, or other organizational needs or activities. Any taxes would only jeopardize present activities and future planning.

We serve a broad segment of our community, including people who enjoy our performances for as little as $3.00 and who could not enjoy such a contribution to their quality of life if Starlight Theatre closed. Thus, our activities are critically important to the very social fabric of our community, and the many smaller surrounding communities which we serve. If any existing revenues are lost...and any tax will cause their loss...our very existence will be threatened.

On behalf of our volunteer Board of Directors, our staff, our numerous volunteer groups assisting us in various areas, our limited private sector donors, and the eleven million citizens who have enjoyed one or more of our performances, we urge you to reject any idea promoting any form of taxation relating to the activities of not-for-profit arts organizations. Such ideas would only serve to vastly eliminate the important contributions such organizations make to the quality of life in communities all across the country.

Thank you for your consideration.

Sincerely,

Robert M. Rohlf

Robert M. Rohlf
General Manager/Producer

RMR/

STATEN ISLAND INSTITUTE OF ARTS AND SCIENCES
75 Stuyvesant Place
Staten Island, New York 10301
(212) 727-1135

Staten Island Museum
High Rock Park Conservation Center
William T. Davis Wildlife Refuge

April 14, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldng.
Washington, D.C. 20515

Dear Mr. Leonard:

I wish to express my profound disagreement with the measures being considered by the Committee on Ways and Means regarding the Unrelated Business Income Tax.

I have been in the nonprofit world for nearly ten years and have as yet to see a nonprofit cultural organization manage more than bare survival without revenue raising activities. The fiscal roller coaster caused by often unpredictable budget cuts, combined with inflationary losses, make it impossible to plan far enough into the future to achieve cost-effectiveness, while threatening programs and services continuously.

I am therefore opposed to the attempt to treat so-called "business income" for nonprofits in the same way as for profit-making organizations for the following reasons:

1. The revenue earned by a nonprofit organization helps it to maintain stability and to offer programs for which no or a low charge ought to be made. In our case, at the Staten Island Institute of Arts and Sciences, this means exhibitions that keep art in the public eye, available to all; and education programs that children of all economic levels can attend.

2. Every time that a nonprofit organizations' ability to provide some sort of "profit-making" service is damaged (and this includes its ability to handle catalogue offerings, telephone sales, travel services, affinity credit cards, advertising income, entertainment facilities, among others), the organization's ability to meet its mission -- to serve the public -- is damaged.

3. The purpose of a nonprofit's "business", be it "directly" or "substantially" related, is different from the purpose of a profit-making business. The nonprofit's "business" is in the service of the public -- and is only participated in by that segment of the public which chooses to do so, while everyone has the benefit of a stable, viable organization.

4. The very issue of "directly" or "substantially" related activities is a false one and clouds the more important issue: Nonprofits engage in revenue producing activities because they cannot rely on governmental support for a consistent and adequate level of financial support.

5. Taxation on a federal level will encourage taxation on a state and local level. All told, it may then become impossible for nonprofits, particularly those that are small and medium sized, to achieve a level of financial stabiltiy that allows for planning and sensible management.

I hope that you and the members of the committee will share my concern that of the Unrelated Business Tax is applied to functions that are now untaxed, the future of many nonprofit cultural organizations will be very much in doubt.

Sincerely,

Susan Malus
Director of Development and Public Relations

STATEN ISLAND INSTITUTE OF ARTS AND SCIENCES
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Staten Island, New York 10301
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Staten Island Museum
High Rock Park Conservation Center
William T. Davis Wildlife Refuge

Royal S. Radin
President

Roy A. Cutter
1st Vice President

Elizabeth M. Seder
2nd Vice President

Richard U. Maren
Treasurer

Bernadette Donahue
Secretary

W.A. Fritz Euler
Chairman
Board of Governors

Patricia Gordon Michael
Executive Director

April 14, 1988

Mr. Robert J. Leonard
Chief Councel
Committee on Ways and Means
US House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard,

I am greatly distressed to learn of the measures being considered by the House Ways and Means Oversight Subcommittee regarding the taxation of not-for-profits' revenue-producing activities. In response to the Subcommittee's call for public comment, I offer these thoughts for its consideration:

My experience with not-for-profit institutions, principally museums but including involvement in other cultural and community organizations, exceeds twenty years. Without revenue producing activities, not-for-profit organizations barely achieve survival, much less growth in the level of service to the community and to future generations. There are so many uncertainties in the funding of not-for-profit - budget cutbacks from governmental granting agencies, reductions in contributions from foundations and corporations, inflationary losses, for example - that planning for the future is virtually impossible and programs and services are threatened continually.

Therefore, I disagree completely with the attempt to treat so-called "business income" of not-for-profits in the same way as that of profit-making organizations. The revenue earned by a not-for-profit organization or institution helps it to maintain stability and to offer programs for which no or a very low charge is made. At the Staten Island Institute of Arts and Sciences, for example, this means we are able to offer exhibitions on art, science and history; educational programs for children and adults which demonstrate, among many other concepts, the interrelationship among the humanities, art and science and the importance of the quality of the environment; a publishing program which strengthens the exchange of ideas and information about science, art and history; we are able to collect, preserve and interpret objects and artifacts which form a substantial portion of the human heritage.

April 14, 1988

Every time a not-for-profit institution's ability to provide some kind of revenue-producing service to help stabilize its funding base is weakened or curtailed, the organization's service to the public - the fulfillment of its mission - is damaged.

The purpose of a not-for-profit organization is substantially different from that of a business. Revenue-producing activities of not-for-profit institutions are for the benefit of the public, for service to the community. These activities are voluntary; only that segment of the public which chooses to do so participates in these activities, yet the entire community benefits from the strength and viability of a not-for-profit organization.

Not-for-profits engage in revenue-producing activities because they cannot rely on government funds for a consistent and adequate level of fiscal support. Taxation on a federal level will encourage taxation on a state and local level. It may then become impossible for not-for-profits, especially those small and medium-sized organizations, to achieve a level of financial stability that allows for confident planning for growth and long-term survival. The imposition of such taxation may also make it impossible for the not-for-profit organization to continue the revenue-producting activity, thus resulting in the loss of financial stability mentioned earlier and in a reduction of service to the public.

The issue before the House Ways and Means Oversight Subcommittee is a crucially important one. Legitimate activities necessary to the future of many not-for-profit organizations will be affected adversely if such measures as those under consideration are adopted.

Very truly yours,

Patricia Gordon Michael
Executive Director

PGM/lc

April 11, 1988

THE
STRONG
MUSEUM

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

On behalf of the Margaret Woodbury Strong Museum, I wish to express deep concern about the proposed changes to the "substantially related test" that the Ways and Means Committee is currently considering in their review of nonprofits' revenue-producing activities.

Many of the nation's 6,000 museums are situated in small communities and operated by volunteers and small staffs and depend heavily on their shop revenues and tours. And many of the nation's larger museums also depend on such revenues to help them preserve this country's irreplaceable cultural legacy.

We urge the Committee to refrain from action that would deprive museums and historical societies, which are so crucial to the quality of life in America, of the resources and revenues that they need to sustain their invaluable contributions to the future of the nation.

Sincerely,

G. Rollie Adams, Ph.D.
President and CEO

GRA:my

1758

SUN INN PRESERVATION ASSOCIATION, INC.

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leanord:

I am writing to you regarding my concerns about the option for changing the unrelated business income tax.

We are a non-profit historical museum that provides free educational programs to students and members of the community. We exist on private donations, memberships and the profits from our small gift shop.

Our funding sources have narrowed down each year for various reasons. We are still trying to continue the operation of the Sun Inn Tavern and return the area surrounding this old (1758) tavern to the way it way originally.

Museums like ours are always in a constant struggle for just operation and maintenence funds. To add another tax burden on us may make it difficult whether we can survive another year, especially in our changing economy of the Lehigh Valley.

Tax proposals like this really hurt the "little guys."

Sincerely,

Mary Anne Hager

Mary Anne Hager

cc:
Kostmayer
D. Ritter
K. Ritter

564 MAIN STREET • BETHLEHEM, PA. 18018 • (215) 866-1758

SWAP NORTHWEST
A CONSORTIUM OF ARTS PRESENTERS

754 GARFIELD, SUITE B
SEATTLE, WA 98109
(206) 284-5877

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Vice President—Oregon
Hult Center for the Performing Arts
Eugene, OR

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Treasurer
University of Washington
Seattle, WA

BRENDA TEALS
Secretary
Columbia Basin Allied Arts
Moses Lake, WA

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Arts Society
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Oregon Arts Commission
Salem, OR

ROBERT McGINLEY
On the Boards
Seattle, WA

JIM OWEN
Idaho Commission on the Arts
Boise, ID

EXECUTIVE DIRECTOR
MARLENE V. MOORE

April 14, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing to express my concern about proposed changes in determination of unrelated business income tax for non-profit agencies.

As the executive director of a small, regional arts service organization, I am constantly struggling to develop financial support for services to our membership of over 70 non-profit arts presenters in the Northwest. This support comes primarily from membership fees and grants from several public arts agencies.

Selected services, including a copy of our directory and five newsletters, are extended to artists, agents and arts managements on an annual subscription basis for a fee.

Approximately 25% of our revenues are derived from membership and subscription fees, mostly solicited by mail or telephone. It would be a definite hardship financially if we were required to pay taxes on any or all of these revenues.

Part of our mission includes producing a conference each year. Fees are charged to participants to help offset direct costs. This revenue also is solicited primarily by mail.

In addition, we secure advertising to help cover the direct costs of our newsletters. Last year it cost us $1,562 for typesetting, graphics and printing, against $872 in advertising revenue. Advertising is directly related to services for our members because they look to these ads to help them learn more about the touring artists and companies who are interested in touring in the Northwest.

Taxing conference fees and/or advertising revenues would certainly constitute a financial set back for us.

Our organization is small, with a budget of about $42,000, with over half of our funding provided by the Washington, Oregon, and Idaho Arts Commissions as well as the National Endowment for the Arts. These agencies are constantly pressuring us to find alternate sources of revenue in order to reduce the demand on public dollars.

Now, many of those very sources of income which we have carefully nurtured and developed are becoming targets for taxation. We feel like we're "damned if we do and damned if we don't".

SWAP Northwest is not in business to make a profit but rather to provide services. We have been granted exemption from taxes on the basis that what we do is for the common good. Any revenue we receive merely helps us to break even financially and ensure that we provide the public service which is expected of us.

I hope the subcommittee will give all proposed changes careful consideration and weigh the impact on private non-profit agencies such as SWAP who are the major, non-governmental sources of public service.

Thank you for considering this information.

Sincerely,

Marlene V. Moore
Executive Director

TAMPA
HEARING AID
CENTER INC.

AUTHORIZED BELTONE
HEARING AID DISPENSER

1821 W. BUFFALO AVE.
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APRIL 11, 1988

HONORABLE J.J. PICKLE, CHAIRMAN
ROBERT J. LEONARD, CHIEF COUNSEL
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE of REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515

IN REGARDS TO REFORM OF THE UNRELATED BUSINESS INCOME TAX (UBIT) SYSTEM. I WANT TO COMMEND THE SUBCOMMITTEE FOR PROPOSING AN EXCELLANT PACKAGE OF REFORM MEASURES. I ALSO ENCOURAGE THE SUBCOMMITTEE TO INCLUDE ALL THESE MEASURES IN ITS FINAL REPORT. ESPECIALLY, I WOULD LIKE TO SEE THEM APPLY (UBIT) TO ALL HEARING AID SALES INCOME OF NONPROFITS.

I ALSO STRESS THE INHERENT COMMERCIAL NATURE OF THESE SALES. AND I ALSO ENCOURAGE THE SUBCOMMITTEE TO REPEAL THE EXISTING "CONVENIENCE" EXEMPTION FOR PATIENTS OR RECOGNIZE PATIENTS AS INPATIENTS ONLY. AND MOST IMPORTANT, THE NONPROFIT COMPETITION IN HILLSBOROUGH COUNTY HAS EFFECTED MY BUSINESS BY 25%. I HAVE BEEN SERVING HILLSBOROUGH COUNTY FOR 10 YEARS. BELTONE HAS BEEN IN HILLSBOROUGH COUNTY SERVING THE HEARING IMPAIRED FOR 35 YEARS.

TO BETTER HEARING

Gerald Amato

GERALD A. AMATO
BOARD CERTIFIED IN HEARING
INSTRUMENT SCIENCES

GA/eg

SPECIALISTS IN SCIENTIFIC FITTING AND SERVICING OF HEARING SYSTEMS

Since 1967
Teachers & Writers Collaborative
5 Union Square West, New York, N.Y. 10003 • 212/691-6590

7 April 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

We are writing to express our urgent and extreme concern over the proposed legislative action on the Unrelated Business Income Tax (UBIT).

We do appreciate the need for tighter controls over those who deliberately misuse and abuse their tax-exempt status. However, the proposed legislation to "correct" the abuses is clearly a case of throwing the baby out with the bath water. Putting a tax on activities such as mail-order ticket sales, catalogue sales, and mailing list exchanges penalizes honest nonprofits for trying to make their services more available to those who need them and to operate more cost effectively.

The vagueness of the proposed legislation would leave many nonprofits confused, forcing them to spend money on costly legal and consultant fees.

While there may be highly visible cases of flagrant abuse by a few nonprofits, our experience is that the nonprofit field consists mostly of small to mid-size groups that pay low salaries and that rely on idealistic, committed staffs. In recent years, many of these groups have developed cost-effective ways to reach their audiences and to raise funds to support their activities. The proposed legislation is a wrong-headed attack on the majority of nonprofits in an attempt to penalize a minority.

Sincerely,

Nancy Larson Shapiro

Nancy Larson Shapiro
Director

PATRICIA PADGETT/Associate Director NANCY LARSON SHAPIRO/Director GARY LENHART/Associate Director RON PADGETT/Publications Director ELIZABETH FOX/Program Director

Teachers & Writers Collaborative is a nonprofit organization partially funded by the New York State Council on the Arts and the National Endowment for the Arts.

CITY OF TEMPE

P.O. Box 5002 Tempe, Arizona 85281 (602) 967-2001

April 12, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard:

I am writing in order to comment on the discussion options relating to the Unrelated Business Income Tax (UBIT). I am the Administrator of a small historical museum run by the City of Tempe, Arizona. Although we are a municipal institution, we derive a great deal of support, both through volunteer manpower and donations, from the Tempe Historical Society, a private non-profit organization. Without the Society's support, we would be unable to function at our current level of funding from the City. The Society owns and runs the Museum's gift shop, the proceeds of which are donated to the Museum. This is a common situation in small museums nationwide. Monies generated by the shop are used to supplement the Museum's budget. Without these funds, we would be unable to purchase storage cabinets and other supplies for exhibits and collections care, send staff to training workshops, or hold special events such as our Territorial Christmas celebration.

In reading option IA regarding the application of the UBIT to gift shop/bookstore income, I foresee three serious problems. First, as stated, this option is vague and hence will be difficult to comply with, as well as enforce. For example, what would qualify as "on-premise sales of an educational nature which relate to the organization visited"? Our Museum deals with the history of Tempe. Would a book about the cotton industry in Arizona, given that cotton was such an important catalyst of Tempe's development, be considered as related to the Museum's mission or not? The gift shop sells a lot of items such as pin cushions and glass bottles which are reproductions of artifacts of a comparable style and period to artifacts in our collection. However, they are not exact duplicates of our artifacts. Would such reproductions be considered related or not?

FRANK PLENCNER, Vice Mayor
DON CASSANO, Councilman
PATRICIA A. HATTON, Councilman

HARRY E. MITCHELL, Mayor
JAMES L. ALEXANDER, City Manager

ROWLAND G. OONK, Councilman
WILLIAM J. REAM, Councilman
CAROL E. SMITH, Councilman

Second, the mixture of taxable and nontaxable inventory would create a bookkeeping nightmare for a gift shop staff which is composed entirely of volunteers. It is very likely that the error factor will increase when volunteers must total up sales including both taxable and nontaxable items. Unlike a chain grocery store, we cannot afford a sophisticated computerized cash register which automatically figures the correct tax. The increased effort which would have to be spent on inventory, bookkeeping and correcting errors would take away volunteer time that is spent on other projects for the Museum. Yet we cannot afford to completely eliminate taxable items since the shop must respond to market pressures in order to remain competitive. I would also suspect that IRS audits of such nonprofit organizations impacted by the UBIT would increase significantly, at least in the first few years of its implementation. Such an increase would place a greater burden on IRS staff and would cost additional taxpayers' dollars.

Third, the proceeds donated to our museum from the gift shop will be reduced significantly. Monies which are not forthcoming from gift shop sales will have to be sought through applications for federal grants. The City of Tempe has allocated substantial funding for a new Museum facility and is not in a position to increase our budget at this time. Private industry is also less likely to donate funds because of the inroads being made on their tax deductible donations.

The Reagan administration has urged nonprofit institutions to shift their fund-raising from the federal government to the private sector. The Museum industry has responded with many creative programs such as gift shops, mail order catalogues, fund-raising events and campaigns for private donations. Such measures as the UBIT hamper our efforts to generate funds from the private sector, leaving us in a position where we will again be forced to increase our requests to the federal government for financial assistance. We are willing to work diligently and apply innovative techniques toward generating our own funding.

Why compromise those efforts when they are directed specifically at reducing the federal government's burden in funding the arts and humanities? Will the increased tax revenue generated by the UBIT offset the costs in terms of enforcement, a loss of volunteer manpower for other projects and reduced private funding for museums, among others? I think that it will not and therefore am against the discussion options (particularly option IA) relating to the UBIT, as currently stated. I urge the Subcommittee on Oversight to carefully consider the costs of the discussion options, both to the federal government and to the nonprofit institutions, before taking action.

TEMPE HISTORICAL MUSEUM

Sincerely,

Amy A. Douglass

Amy A. Douglass, Ph.D.
Museum Administrator

AAD/ggs

TEXAS HEARING AID ASSOCIATION
222 N. Riverside Dr. • Ft. Worth, TX 76111 • (817) 831-0592

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April 12, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The House Ways and Means Oversight Committee is proposing an excellent package dealing with unfair competition by non-profit organizations. Reforms of the Unrelated Business Income Tax (U.B.I.T.) System is long overdue and much needed. Texas Hearing Aid Association's Legislative Committee strongly supports the reforms that are being proposed. We urge the Subcommittee to include ALL these measures in the final report.

T.H.A.A. encourages the repeal of the existing "convenience" exemption for patient. If this is not done, at lease recognize the term "patients" as meaning inpatients, only.

Application of U.B.I.T. to ALL hearing aid sales income to non-profits is encouraged. There has been much abuse by non-profits to small businesses in Texas through their unfair competition. Rehabilitation Centers, that are funded through Easter Seals, are agressively engaged in commercial sales under the guise of just providing for their patients. In reality, MOST of their income is through commercial sales in direct competition with small businesses. "The Hearing Aid Journal" (May 1987 Issue) reported that in 1983 over 76% of the Rehabilitation Centers gross income was from sales.

Please include ALL the Subcommittee's excellent package of reform for U.B.I.T. This step would help in stopping the unfair practice of giving our tax dollars to subsidize entities that are agressively and unfairly competing with us.

Sincerely,

Curt Wallis

Curt Wallis, Legislative
Committee Chairman
Texas Hearing Aid Association

TEXAS HEARING AID ASSOCIATION
222 North Riverside Dr. Fort Worth, TX 76111 (817) 831-0592

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EXECUTIVE DIRECTOR
Jim Wilson
222 N. Riverside Dr.
Fort Worth, TX 76111
(817) 831-0592

April 12, 1988

TO: House Ways and Means Oversight Subcommittee

FROM: Jim Wilson, Executive Director
Texas Hearing Aid Association

RE: Unrelated Business Income Tax system that applies to nonprofit organizations.

Please apply the UBIT to all hearing aid sales income (including hearing testing and aural rehabilitation) of nonprofit organizations, including the University of Texas, state hospitals and United Way agencies.

Two items in the Subcommittee's discussion options we wish to comment on. The first is Section I., A., (3). in the case of a hospital, articles generally used by or for inpatients. (4). in the case of a university, articles in furtherance of education programs...

Please strengthen the law to keep hospitals from fitting hearing aids on their inpatients as a benefit for checking into their hospital. It is being done at veterans' hospitals. If you exempt hospital inpatients they will continue this practice.

In the case of universities, please strengthen the law to prevent university programs from hiding behind the clause "...in furtherance of educational programs." This all encompassing facade has been the shield of protection which university professors hold up whenever their programs are challenged.

An approach to skirt IRS law which many Texas state funded universities use in their hearing aid dispensing programs, is mail order. The University of Texas at Dallas' Callier Center for Communication Disorders acts as a sales agent for a mail order hearing aid manufacturer located in Kalamazoo, Michigan. Using this method, Callier tests the citizen, measures for the proper type of hearing aid, fills out a mail-order form for the customer and handles the payment. The customer, however, is asked to make their check out to the Kalamazoo manufacturer. The company fills the order and mails the hearing aid back to Callier, where a student will fit the device on the customer. So if you ask the University if they "sell" hearing aids, they will say "no." They will say they only take a fee for testing and rehabilitation.

This unfair practice is hurting local businesses. It is costing tax-paying businesses profits which would have been made on (1) the sale of the hearing aid; (2) testing and; (3) aural rehabilitation.

The second point we would like to discuss is section X, Miscellaneous, paragraph two: Exempt from UBIT an organization's contingent rental income received through a prime tenant, where the prime tenant leases real estate from a tax-exempt organization, the prime tenant's net profits are based on fixed rents derived from subtenants, and the prime tenant does not provide services to subtenants except through an independent contractor.

We question if this is strong enough. A true example: The Aston Center is a facility of the University of Texas at Dallas. It is tax exempt. It is on campus. The Aston Center rents space to a for-profit enterprise named University Consultants, which is a hearing aid sales company. The space which Aston Center rents to University Consultants was not made available on a competitive bid basis. Area hearing aid companies were not given the opportunity to bid on the space. Instead, a group of doctors who teach at the university rented space quietly to themselves at a below market rate. The income the state university derives from rent is very nominal. Therefore, the UBIT is hardly enough to discourage this practice. Yet University Consultants enjoys a competitive advantage due to the university location, the image which comes by appearing to be part of the university, and through the referrals the professors make to themselves.

Representative Pickle, you will never know how thankful we are to you and this subcommittee on oversight. We are very proud that you are taking this so seriously. Thank you.

Jim Wilson,
Executive Director,
Texas Hearing Aid Association

222 N. Riverside Drive
Fort Worth, Texas 76111

April 14, 1988

TO: Honorable J.J. Pickle

FROM: Jim Wilson, Executive Director
Texas Hearing Aid Association

RE: This is a sample of an ad being used by a non-profit organization to sell hearing aids.

DAD, continued from page 3

2) Community services - for those inclined, committees are formed to meet and help with various problems affecting the hearing-impaired people.

3) Sports - we are known for our extensive sports programs for the youth (18 years old and up). We annually field teams in softball, basketball, and have programs to establish volleyball, bowling and golf. We pay for most of the cost of these sports activities from the funds raised through various club activities.

4) Culture - we have a group of people who give musical performances, and from time to time invite professionals to appear on our stage.

5) Leadership - too often, hearing-impaired people do not have the opportunity to participate in meetings and debates. Our general and business meetings give everyone an opportunity to utilize their, perhaps, hidden talents in leadership.

DAD's long-range goal is to provide the best social outlet as well as offering other services to the hearing-impaired people ofthe Metro Dallas area.

WE constantly seek new members, as we realize that each new person brings with him or her a fresh infusion of ideas and talents - and this is what we desire to keep our association strong. Not many people know that we are the third largest hearing-impaired club in the country in terms of membership.

DAD is open every Friday and Saturday from 7:30 p.m. until 2:00 a.m. Newsletter/activities will be mailed on request. You are invited to come by and ask any Board member or officer of DAD for further information.

Publisher's Note: A trip to DAD can be an enlightening and enjoyable experience. The members are friendly and eager to assist anyone who comes to their club.

UTD

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Hurst, TX 76053
(817) 284-2038

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447-2322 Metro

Bring this coupon for:

Free Hearing Test

Special Prices on All Instruments With This Ad

NEED TO CONTACT THE ELECTRIC COMPANY?

TU Electric telephone lines for the hearing-impaired in the Metroplex are:

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Arlington	Cockrell Hill	Addison	Farmers Branch
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Grand Prairie		Cedar Hill	Irving
Haltom City		Colleyville	Lancaster
Hurst		Coppell	Mesquite
Lake Worth		DeSoto	Plano
Mansfield		Duncanville	Richardson
North Richland Hills		Euless	Sunnyvale
Richland Hills			
Westover Hills			
White Settlement			

TUELECTRIC

COMMENTS OF THE
TEXTILE RENTAL SERVICES ASSOCIATION OF AMERICA
ON THE HOUSE WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
DISCUSSION OPTIONS RELATING TO
THE UNRELATED BUSINESS INCOME TAX

Dear Chairman Pickle:

On behalf of the Textile Rental Services Association of America, a trade association representing over 1,400 taxpaying textile rental companies, we would like to commend you and your Subcommittee for proposing for public comment an excellent package of reform measures regarding the unrelated business income tax (UBIT).

Due to a major effort by many in-house nonprofit hospitals to solicit customers away from our for-profit textile rental companies, TRSA testified at the Subcommittee's series of hearings on UBIT in June, 1987. We argued that non-profit hospitals should not be permitted to use their in-house laundries to provide laundry service to commercial accounts including other hospitals, profit or non-profit.

At this time, we would like to once again express our concern to the Subcommittee that our industry is still detrimentally affected by the commercial activities of many tax-exempt hospital laundries.

This unfair competitive activity continues in spite of the fact that the Internal Revenue Service Code requires hospitals to pay taxes on unrelated business income. In-house accounting systems enable nonprofit hospitals to misallocate expenses such as energy (water and sewage), utilities, space, costs of supplies and equipment, administration, and depreciation to their laundry operations. As a result, for tax purposes, most of these hospital laundries claim they operate on a break-even basis and therefore, do not have to pay tax.

We would like to see these tax loopholes tightened. Under discussion option VIII, Allocation Rules, TRSA urges the Subcommittee to consider specific proposals that would further reduce the amount of fixed costs allocable between commercial and exempt use, and limit deductible expenses to fair market value of the goods or services provided.

As an industry, we are willing to compete fairly, however, without meaningful reform of UBIT, and a tightening of existing tax loopholes, textile rental companies will face continued loss of revenue and reduced employment.

In conclusion, TRSA supports the Subcommittee's preliminary discussion options for reform of UBIT and requests that the Subcommittee consider TRSA's recommendations for the textile rental industry as presented at the hearings last June:

- Nonprofit hospitals should not be allowed to offer laundry services to any outside entity.
- Recognized accounting practices must be required for all existing nonprofit corporations engaged in activities that generate unrelated business income.
- Not-for-profit hospital laundry groups must be required to pay their fair share of property and local taxes (i.e., state, county, city and local property and other taxes).

The Textile Rental Services Association of America appreciates your continued interest in the problem and commends your leadership in developing constructive and fair UBIT reform recommendations to the full Committee.

Sincerely,
John J. Contney
Executive Director
Textile Rental Services Association
of America

THEATRE
COMMUNICATIONS
GROUP INC. the national organization for the nonprofit professional theatre
355 LEXINGTON AVENUE NEW YORK, NY 10017 (212) 697-5230

TESTIMONY SUBMITTED

BY

THEATRE COMMUNICATIONS GROUP

Theatre Communications Group is pleased to submit these comments to the House Ways and Means Oversight Subcommittee as it reviews options relating to the unrelated business income tax for tax-exempt organizations. Theatre Communications Group (TCG), founded in 1961, is the national service organization for the nonprofit professional theatre, providing services and programs that facilitate the work of thousands of theatre artists, managers and trustees, as well as a constituency of over 275 theatre institutions across the country.

Like many nonprofit organizations, noncommercial theatres are facing troubled economic times, with an already shaky financial climate aggravated by the change in federal tax laws for individuals as well as stagnation in federal arts funding levels. The most recent fiscal survey of TCG's members shows that in 1987 increases in operating expenses outpaced growth in contributions; contributions from individuals experienced the smallest growth in five years; corporate support grew by 10 percent -- but much more slowly than the 15-17 percent in each of the previous three years; federal government support declined by 8 percent and state government support dropped 11 percent. Federal funding of member theatres, in the form of grants from the National Endowment for the Arts, represented less than 4 percent of the theatres' operating costs, the lowest figure since the survey was instituted fourteen years ago. These trends have all increased the need for theatre companies to rely on earned income.

To help offset reductions in contributed income while maintaining affordable ticket prices that promise accessibility to all segments of society, nonprofit theatres and other arts organizations have been forced to respond to the Reagan Administration's encouragement of private partnerships by developing new avenues for earning additional income, including from concession activities, program advertising, rentals and royalties. The 188 theatres surveyed in 1987 reported income from these ancillary sources which covered just 7 percent of their total operating expenses for that year, but which helped enable the participating theatres to eliminate their aggregate deficit for the first time in five years. Nevertheless, the impact of the Tax Reform Act of 1986 on individual giving, as well as the stock market crash, the spree of corporate mergers and the federal deficit all threaten to further erode the fragile economy of support for the nonprofit theatre.

In light of the above, it is therefore extremely difficult to embrace certain of the UBIT options under consideration by the subcommittee. Instead of alleviating the financial pressure caused, in part, by federal legislation, the current proposals under consideration by the House Ways and Means Oversight Subcommittee would have a profound negative effect on Theatre Communications Group and its 275 member theatres should they become law. In the most extreme instances, the continued existence of theatre companies would be threatened; at the very least, there would be a marked curtailment of activities that support the theatres' primary programs which could cripple the development and production of new American plays.

The following areas are of primary concern to Theatre Communications Group and its members:

1. Catalog/mail/phone order "off-premise" sales. While the intent of this proposal is unclear in its current form, one interpretation is that all phone and mail order ticket sales would be subject to UBIT. Taxing this primary source of income would have a devastating effect on our subscription-based theatres, many of which sell over 90 percent of all tickets through telephone, mail order and remote outlet sales, and could certainly cause many of them to cease operation. In addition to the theatres' own sales efforts, off-premise ticket sales outlets, including nonprofit discount ticket booths, Ticketron and Telecharge, are utilized by a majority of our member theatres who are continually searching for new ways of reaching new audiences.

In the case of Theatre Communications Group, which operates as a nonprofit small press as well as a service organization, 99 percent of our sales are conducted through our catalog, mail orders and other distributors. These publications serve an educational function and serve a purpose not filled by commercial publishers. According to Publisher's Weekly, the number of performing arts books published annually have been on a yearly decline since 1981 due to their lack of profitability for commercial publishers.

It is essential that the subcommittee clarify that any tax on catalog/mail/phone order "off-premise" sales would not apply to items directly related to the organization's primary tax-exempt purpose.

2. Royalties. Whereas several decades ago the commercial theatre was the primary source of new plays, today virtually all new American plays are developed in the country's nonprofit theatre arena, where the climate is more hospitable to the lengthy and sensitive creative process between playwrights, directors, designers and actors. In many cases the theatre collaborates, in a sense, in the "authorship" of a new play by playing an active role in bringing artistic personnel together and providing the financial resources for an extended period of play development, and might participate in future royalties from gross and/or net receipts. Still, royalty income represented less than one-quarter of one percent of all income earned by TCG's member theatres in 1987, and does not figure prominently in any theatre's operating budget. This income is considered "substantially related" insofar as it represents the theatres' contributions to the development of new artistic works. And more important, any royalties earned are fed back into the theatre institutions in order to continue new play development programs.

3. Advertising. Many theatres sell advertising in order to produce program books and other journals which are provided free of charge to theatre patrons both as educational guides and enhancements to the plays produced. TCG's monthly American Theatre magazine, the only national general-circulation theatre magazine, relies on its advertising income, which covers only a small fraction of its direct production, overhead and promotional expenses, to support its editorial content. The proposed taxation of all income from advertising, while allowing deduction from UBIT only for direct advertising costs, would at the very least seriously reduce these activities and even jeapordize their continued existence. The current law, which taxes advertising income net of all publications expenses is adequate protection against abuses.

It is important to emphasize that in neither the case of additional taxes from advertising revenues or royalty income would the federal government stand to gain substantial income, yet the loss of such income would be of great harm to these nonprofit theatres.

In addition to the specific considerations mentioned above, adoption of the current proposal would result in taxing many other activities that theatres regard as part of their ongoing endeavors to raise charitable contributions, including annual fundraising events for which goods sold are not donated and services are not provided free, and contribution campaigns in which low-cost items such as tee-shirts and posters are given as premiums to contributors.

In closing, TCG urges the committee to carefully and thoroughly evaluate the various options set forth in the current proposal before instituting changes in the current UBIT law that could have serious, if not disastrous, ramifications for the country's great cultural institutions. We offer our full cooperation and support as this oversight review continues, and hope that we can be of assistance to the Subcommittee during this process.

Enclosed are a copy of Theatre Communication Group's 1987 fiscal survey of member theatres, our current publications catalog, and current membership list.

[ADDITIONAL ATTACHMENTS TO THIS STATEMENT ARE BEING RETAINED IN THE COMMITTEE FILES.]

THEATRE
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FOR RELEASE: MARCH 18, 1988 CONTACT: LINDY ZESCH

LATEST TCG SURVEY REVEALS BOTH GAINS AND LOSSES FOR THE NATION'S THEATRES; FUTURE GROWTH MAY DEPEND ON NATIONAL AND GLOBAL ECONOMIC TRENDS

NEW YORK -- THEATRE FACTS 87, the latest annual report on the financial condition of America's theatres was released this week by Theatre Communications Group, the national organization for the nonprofit professional theatre. The survey reveals a mixture of positive and negative trends, along with a slightly improved bottom-line picture for the field.

According to TCG, in 1987, box office income rose, attendance grew slightly to reach a five-year high, support from foundations showed a healthy increase, and income from endowment funds and fund-raising events increased markedly. However, the growth rate of private contributions, especially from the two leading sources -- individual and corporate donors -- was the smallest in five years, while federal and state support dollars dropped sharply. A modest increase in expenses indicates a year of little expansion of activity, while compensation levels for artists and other personnel did not keep pace with the low-level inflation.

"This year's survey does not reflect a consistent progression, but rather changing patterns that make long-range planning extremely difficult for theatre staffs and trustees," observes TCG director Peter Zeisler. "Each year brings new conditions; by the time goals are readjusted, another year has passed and another set of conditions prevails. Progress does not seem to stride forward, but proceeds laterally, crab-like. In such a climate, we must be very sure that the art -- as well as the machinery that supports it -- is well nourished."

"The 1987 data serves to underscore the fragile and complex nature of theatre financing, and the vulnerability of nonprofit organizations to a wide range of economic factors," agrees Lindy Zesch, TCG's associate director who authored the report. "Theatres currently face the potential effects of tax reform, the recent stock market crash, a growing federal deficit, and an ongoing spree of corporate mergers and acquisitions -- all of which could affect future earnings and support from both private and governmental sources."

The 188 nonprofit professional theatres participating in the 1987 TCG survey represent 108 cities located in 38 states and the District of Columbia. They reflect the diversity of the national theatre field, including small, adventurous ensembles located in urban neighborhoods; experimental troupes; companies serving rural and minority audiences; and established cultural institutions in major metropolitan areas. Their varied programming includes classics, modern plays and musicals, new plays by contemporary authors, mime, interdisciplinary and performance art works.

The 188 theatres played to a total audience of 14.6 million during the 1986-87 season, presenting 46,768 performances of 2,427 productions, and employing a work force of 23,620. Their budgets ranged from under $100,000 to nearly $10 million, and together they constituted a $273 million industry. While the bottom line for the total survey universe reflects a negative fund balance of $1.6 million, with 85 of the theatres ending the year in the red, the picture is significantly improved over the previous four years. More than half of the field posted deficits each year from 1983 to 1985, but the proportion declined to 45 percent in 1987.

The TCG survey includes a five-year trend analysis for a sample group of 48 theatres. Among the sample group income grew slightly faster than expenses for the second consecutive year. The sample theatres fared better than the overall survey universe, posting a small aggregate operating surplus ($587,909) for the first time in the five-year period. Two years earlier, these theatres registered a staggering $2.4 million aggregate deficit. Nevertheless, 20 of the 48 theatres still reported 1987 deficits, and seven of the shortfalls exceeded $100,000, evidence that the improved picture for the field as a whole cannot yet be said to extend to all of its component parts.

Following are some other sample group highlights from the 1987 survey:

Productivity

*The average sample theatre presented 267 performances of seven mainstage productions, as well as 38 performances of five ancillary offerings, over a playing season of 35 weeks.

Earnings

*Altogether, earned income from all sources increased 6.8 percent.

*Total box office income grew by 8.5 percent, caused by growth in attendance and rising ticket prices. More than half of all mainstage seats were occupied by subscribers, and subscription audiences ranged in size from under 3,000 to over 50,000.

*One of the most promising developments in the theatre earnings picture is the growth in recent years of income-generating endowment funds. Altogether, 27 of the 48 theatres had established endowments by 1987, compared to only 16 five years earlier.

Expenses

*Total operating costs for the 48 sample theatres rose by less than 6 percent in 1987, the smallest annual growth in the five-year period.

*Personnel compensation in the form of salaries, fees and fringe benefits rose by less than 3 percent in 1987, and did not keep pace with the 3.9 percent inflation or with other expenses.

*Royalties to playwrights, composers and lyricists rose 19 percent above the previous year's level. Since the number of properties on which royalties were paid declined slightly from the previous year, the royalty increase represents higher compensation to dramatists in 1987.

Grants & Contributions

*Although contributed income has grown much faster than either expenses or earnings since the early 1980s, this trend did not continue in 1987, as earnings and expenses both outpaced the 5.4 percent growth in grants and contributions.

*Gifts from individuals, the largest source of contributions to theatres, experienced the smallest growth in the five-year period, up less than 5 percent over 1986, and well behind the 11 to 23 percent increases seen annually since 1983.

*Corporate support remained the second most important source of theatre contributions in 1987 but the survey clearly demonstrates that the predicted slowdown in corporate giving growth has begun to hit the sample theatres. Corporate support grew by a solid 10 percent in 1987, but significantly below the gains of 15 to 17 percent in each of the three previous years.

*Foundation grants to the sample theatres increased faster than any other major form of private support, rising more than 12 percent over the previous year's level.

*Federal support to sample theatres, primarily from the National Endowment for the Arts, fell by more than 8 percent in 1987. The drop was partly caused by the impact of the 4 percent Gramm-Rudman-Hollings automatic spending cuts that affected half of all domestic programs for federal fiscal year 1986. Over the five-year life of the TCG survey, theatre operating costs have climbed nearly 39 percent, while NEA appropriations have risen only 10.5 percent.

*State government funding to the sample theatres registered a drop of 11 percent, in spite of increased arts appropriations from state legislatures, reversing a pattern of annual growth since 1983.

"Municipal and county governments provided funding to 30 of the 48 sample theatres during 1987, as local support showed an impressive increase for the second consecutive year, topping last year's total by 34 percent.

"America's theatres were undercapitalized from the beginning, and spent several decades striving to achieve a solid financial base," Zesch believes. "The progress over the past several years toward a more reasonable measure of contributed support and away from a heavily box-office-based economy, has certainly been a positive development. Theatre leaders are making the point that theatre cannot rely too heavily on box office income, that it needs increased subsidy. The sources of that subsidy, however, may be threatened by a variety of vascillating economic forces that make future trends impossible to predict."

"The more the cold statistics are pondered, the more one discovers questions that are not readily quantifiable -- and even less forecastable," says Zeisler. "Much progress has been made, but today's theatres are concerned about finding new, younger and ethnically diverse audiences; they need to devote more resources to research and development activities; their administrative salaries must become more competitive to attract staffs qualified to run increasingly complex organizations; and, they must make significant progress in the vital area of artist compensation if the American theatre is to provide a real home for our most talented artists."

TCG, the national organization for the nonprofit professional theatre has conducted national surveys annually since 1974. Under the direction of Barbara Janowitz Ehrlich, research data was compiled by John Hedges, with the assistance of Christina Colando, all members of TCG's Management Services staff.

Theatre Facts 87, containing the full text of the survey report, graphs and tables, will appear in the April 1988 issue of American Theatre, the national theatre magazine published by TCG. Copies are available for $3.50, plus $1.50 postage and handling, from: Publications Dept., Theatre Communications Group, 355 Lexington Avenue, New York, NY 10017.

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(Note: a regional list of TCG constituent and associate theatres is attached)

3/88

1987 TCG Survey - Participating Theatres

Alabama

Alabama Shakespeare Festival

Alaska

*Alaska Repertory Theatre
Perseverance Theatre

Arizona

*Arizona Theatre Company

Arkansas

The Arkansas Art Center Children's Theatre
Arkansas Repertory Theatre

California

American Conservatory Theatre
Antenna Theatre
*Berkeley Repertory Theatre
Berkeley Shakespeare Festival
Bilingual Foundation of the Arts
Dell'Arte Players Company
East West Players
Eureka Theatre Company
Grove Theatre Company
La Jolla Playhouse
Lamb's Players Theatre
L.A. Theatre Works
Marin Theatre Company
*Mark Taper Forum
Odyssey Theatre Ensemble
*Old Globe Theatre
One Act Theatre Company of San Francisco
PCPA Theaterfest
San Diego Repertory Theatre
San Francisco Mime Troupe
San Jose Repertory Company
*South Coast Repertory
TheatreWorks
The Will Geer Theatricum Botanicum

Colorado

Denver Center Theatre Company
Germinal Stage Denver
Theatreworks/Colorado

Connecticut

*Hartford Stage Company
*Long Wharf Theatre
National Theatre of the Deaf
O'Neill Theater Center
*Yale Repertory Theatre

District of Columbia

*Arena Stage
Ford's Theatre
*Shakespeare Theatre at the Folger
The Studio Theatre
Woolly Mammoth Theatre Company

Florida

*Coconut Grove Playhouse
Florida Studio Theatre
The Playmakers
Red Barn Actor's Studio

Georgia

Academy Theatre
*Alliance Theatre Company

Hawaii

Honolulu Theatre for Youth

Idaho

Idaho Shakespeare Festival

Illinois

The Body Politic Theatre
Center Theater
Free Street Theater
*Goodman Theatre
Illinois Theatre Center
National Jewish Theater
New American Theater
*Northlight Theatre
Remains Theatre
Steppenwolf Theatre Company
Victory Gardens Theater
Wisdom Bridge Theatre

Indiana

Indiana Repertory Theatre

Iowa

The Old Creamery Theatre Company

Kansas

Music Theatre of Wichita

Kentucky

*Actors Theatre of Louisville
Horse Cave Theatre
Roadside Theater
Stage One: The Louisville Children's Theatre

Maine

Portland Stage Company

Maryland

*Center Stage

Massachusetts

*American Repertory Theatre
The Berkshire Public Theatre
Berkshire Theatre Festival
Gloucester Stage Company
*Huntington Theatre Company
Merrimack Repertory Theatre
*StageWest

Michigan

BoarsHead: Michigan Public Theater
Detroit Repertory Theatre

Minnesota

Actors Theatre of St. Paul
*The Children's Theatre Company
The Cricket Theatre
*The Guthrie Theater
Mixed Blood Theatre Company
The Playwrights' Center
Theatre de la Jeune Lune

Mississippi

New Stage Theatre

Missouri

*Missouri Repertory Theatre
*The Repertory Theatre of St. Louis
Theatre Project Company
Unicorn Theatre

Nebraska

Emmy Gifford Children's Theater
Nebraska Repertory Theatre
Nebraska Theatre Caravan

New Hampshire

American Stage Festival

New Jersey

*George Street Playhouse
*McCarter Theatre
New Jersey Shakespeare Festival
Paper Mill Playhouse
South Jersey Regional Theatre
Whole Theatre

New York

The Acting Company
AMAS Repertory Theatre
The American Place Theatre
Arena Players Repertory Theatre of Long Island
Capital Repertory Company
*Circle in the Square Theatre
*Circle Repertory Company
Coney Island, USA
Creative Arts Team
Empire State Institute for the Performing Arts
The Fiji Company
INTAR Hispanic American Arts Center
Irondale Ensemble Project
Jean Cocteau Repertory
Lincoln Center Theater
Mabou Mines
Manhattan Punch Line Theatre
*Manhattan Theatre Club
Mettawee River Company
Music-Theatre Group
New Dramatists
The New Theatre of Brooklyn
New York Theatre Workshop
Ontological-Hysteric Theater
Pan Asian Repertory Theatre
Puerto Rican Traveling Theatre
Repertorio Espanol
The Second Stage
*Studio Arena Theatre
*Syracuse Stage
Theatre for a New Audience
Theater for the New City
Vineyard Theatre

North Carolina

PlayMakers Repertory Company

Ohio

*Cincinnati Playhouse in the Park
*The Cleveland Play House
*Great Lakes Theater Festival
Little Miami Theater Works
Players Theatre of Columbus

Oregon

New Rose Theatre
Oregon Shakespearean Festival
Storefront Theatre

Pennsylvania

The Actors' Company of Pennsylvania
The Bloomsburg Theatre Ensemble
City Theatre Company
Fulton Opera House
The Independent Eye
*Pennsylvania Stage Company
*The People's Light and Theatre Company
*Philadelphia Drama Guild
Philadelphia Festival Theatre for New Plays
The Philadelphia Theatre Company
*Pittsburgh Public Theater
Three Rivers Shakespeare Festival
Touchstone
The Walnut Street Theatre

Rhode Island

Looking Glass Theatre
Rites and Reason
*Trinity Repertory Company

Tennessee

Clarence Brown Theatre Company
Cumberland County Playhouse
Playhouse on the Square

Texas

A.D. Players
*Alley Theatre
Dallas Theater Center
Stages Repertory Theatre
Stage West

Utah

Pioneer Theatre Company
The Salt Lake Acting Company

Virginia

*Barter Theatre
Mill Mountain Theatre
*TheatreVirginia
Virginia Stage Company

Washington

*A Contemporary Theatre
*The Empty Space Theatre
The Group Theatre Company
*Intiman Theatre Company
*Seattle Repertory Theatre
*Tacoma Actors Guild

Wisconsin

FMT
Milwaukee Chamber Theatre
*Milwaukee Repertory Theater

*denotes survey Sample Group

TCG THEATRES

Constituents

Academy Theatre
A Contemporary Theatre
The Acting Company
Actors Theatre of Louisville
Actors Theatre of St. Paul
Alabama Shakespeare Festival
Alaska Repertory Theatre
Alley Theatre
Alliance Theatre Company
AMAS Repertory Theatre
American Conservatory Theatre
American Jewish Theatre
American Place Theatre
American Players Theatre
American Repertory Theatre
The American Stage Company
American Stage Festival
American Theatre Company
Antenna Theater
Arena Stage
Arizona Theatre Company
Arkansas Arts Center Children's Theatre
Arkansas Repertory Theatre
Asolo Performing Arts Center
A Traveling Jewish Theatre
At the Foot of the Mountain
Attic Theatre
The Back Alley Theatre
Barter Theatre
Bathhouse Theatre
Berkeley Repertory Theatre
Berkeley Shakespeare Festival
Berkshire Theatre Festival
Bilingual Foundation of the Arts
Bloomsburg Theatre Ensemble
BoarsHead: Michigan Public Theater
Body Politic Theatre
Caldwell Theatre Company
California Theatre Center
Capital Repertory Company
The CAST Theatre
Center for Puppetry Arts
Center Stage
Center Theater
The Changing Scene
The Children's Theatre Company
Cincinnati Playhouse in the Park
Circle in the Square Theatre
Circle Repertory Company
City Theatre Company
Clarence Brown Theatre Company
The Cleveland Play House
Coconut Grove Playhouse
Creative Arts Team
The Cricket Theatre
Crossroads Theatre Company
CSC Repertory Ltd.
Cumberland County Playhouse
Dallas Theater Center
Delaware Theatre Company
DellArte Players Company
Denver Center Theatre Company
Detroit Repertory Theatre
Dorset Theatre Festival
East West Players
Emmy Gifford Children's Theater
ESIPA
The Empty Space Theatre
The Ensemble Studio Theatre
Eureka Theatre Company
The Fiji Company
Florida Studio Theatre
FMT
Ford's Theatre
Free Street Theater
Fulton Opera House
George Street Playhouse
Germinal Stage Denver
GeVa Theatre
Goodman Theatre
Goodspeed Opera House
Great American Children's Theatre Co.
Great Lakes Theater Festival
The Group Theatre Company
Grove Theatre Company
The Guthrie Theater
Hartford Stage Company
The Hippodrome State Theatre
Honolulu Theatre for Youth
Horse Cave Theatre
Hudson Guild Theatre
Huntington Theatre Company
Illinois Theatre Center
Illusion Theater
The Independent Eye
Indiana Repertory Theatre
INTAR
Interart Theatre
Intiman Theatre Company
Jean Cocteau Repertory
Jewish Repertory Theatre
La Jolla Playhouse
Lamb's Players Theatre
Lamb's Theatre Company
L.A. Theatre Works
Lincoln Center Theater
Living Stage Theatre Company
Long Island Stage
Long Wharf Theatre
Looking Glass Theatre
Los Angeles Theatre Center
Mabou Mines
Magic Theatre
Manhattan Punch Line Theatre
Manhattan Theatre Club
Marin Theatre Company
Mark Taper Forum
McCarter Theatre
Merrimack Repertory Theatre
Milwaukee Repertory Theater
Mirror Repertory Company
Missouri Repertory Theatre
Mixed Blood Theatre Company
Musical Theatre Works
Music-Theatre Group
The National Theatre of the Deaf
Nebraska Theatre Caravan
New American Theater
New Dramatists
New Federal Theatre
New Jersey Shakespeare Festival
New Mexico Repertory Theatre
New Playwrights' Theatre
New Stage Theatre
New York Shakespeare Festival
New York Theatre Workshop

Northlight Theatre
Oakland Ensemble Theatre
Odyssey Theatre Ensemble
Old Creamery Theatre Company
Old Globe Theatre
Omaha Magic Theatre
One Act Theatre Company of
San Francisco
O'Neill Theater Center
Ontological-Hysteric Theatre
The Open Eye: New Stagings
Oregon Shakespearean Festival
Organic Theater Company
Pan Asian Repertory Theatre
Paper Mill Playhouse
PCPA Theaterfest
Pennsylvania Stage Company
People's Light and Theatre Company
Periwinkle National Theatre for
Young Audiences
Perseverance Theatre
Philadelphia Drama Guild
Philadelphia Festival Theatre for
New Plays
The Philadelphia Theatre Company
Pioneer Theatre Company
Pittsburgh Public Theater
Playhouse on the Square
The Playmakers
PlayMakers Repertory Company
The Playwrights' Center
Playwrights Horizons
Portland Stage Company
Puerto Rican Traveling Theatre
Remains Theatre
Repertorio Español
Repertory Theatre of St. Louis
River Arts Repertory
The Road Company
Roadside Theater
Round House Theatre
Sacramento Theatre Company
Salt Lake Acting Company
San Diego Repertory Theatre
San Francisco Mime Troupe
San Jose Repertory Company
Seattle Children's Theatre
Seattle Repertory Theatre
The Second Stage
Shakespeare Theatre at the Folger
Snowmass Repertory Theatre
Society Hill Playhouse
Soho Repertory Theatre
South Coast Repertory
Stage One: The Louisville
Children's Theatre
Stage West
StageWest
Steppenwolf Theatre Company
The Street Theater
Studio Arena Theatre
The Studio Theatre
Syracuse Stage
Tacoma Actors Guild
The Theater at Monmouth
Theatre de la Jeune Lune
Theatre for a New Audience
Theater for the New City
Theatre IV
Theatre Project
Theatre Project Company
TheatreVirginia
Theatreworks/USA
Theatre X
Trinity Repertory Company
Unicorn Theatre
Victory Gardens Theater
Vineyard Theatre
Virginia Stage Company
Walnut Street Theatre
Whole Theatre
Williamstown Theatre Festival
The Wilma Theater
Wisdom Bridge Theatre
The Wooster Group
Worcester Foothills Theatre Company
WPA Theatre
Yale Repertory Theatre

Associates

Actors Alliance Theatre Company
The Actors' Company of Pennsylvania
A. D. Players
Amistad World Theatre
Arena Players Repertory Theatre of
Long Island
Arrow Rock Lyceum Theatre
Bailiwick Repertory
The Berkshire Public Theatre
Boston Post Road Stage Company
Burbage Theatre Ensemble
Clavis Theatre
The Colony Theatre Company
Coney Island, USA
Detroit Center for Performing Arts
Downtown Cabaret Theatre of
Bridgeport
Ensemble Theatre Project
Gloucester Stage Company
Hangar Theatre
Horizons: Theatre from a Woman's
Perspective
Idaho Shakespeare Festival
Irondale Ensemble Project
Little Miami Theater Works
Madison Repertory Theatre
Merry-Go-Round Playhouse
Mettawee River Company
Mill Mountain Theatre
Milwaukee Chamber Theatre
Music Theatre of Wichita
National Jewish Theater
Nebraska Repertory Theatre
New City Theater
The New Rose Theatre
The New Theatre of Brooklyn
Padua Hills Playwrights' Workshop
Peterborough Players
Players Theatre Columbus
Porthouse Theatre Festival
The Puppet Workshop
Quaigh Theatre
Red Barn Actor's Studio
Rites and Reason
South Jersey Regional Theatre
Spokane Interplayers Ensemble
Stages Repertory Theatre
Stages Theatre
Stop-Gap
Storefront Theatre
The Talking Band
The Tampa Players
Tennessee Repertory Theatre
Thalia Spanish Theatre
Theatre Three Productions
Theatreworks/Colorado
TheatreWorks
Three Rivers Shakespeare Festival
Touchstone
Will Geer Theatricum Botanicum
Woolly Mammoth Theatre Company

Thornton W. Burgess Society

Thornton W. Burgess Museum
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Sandwich, MA 02653
(617) 888-4668

Green Briar Nature Center
6 Discovery Hill Road
E. Sandwich, MA 02537
(617) 888-6870

April 8, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I am writing on behalf of the Thornton W. Burgess Society, a non-profit organization located in Sandwich, Massachusetts, in response to your request for comments on the proposed changes in the unrelated business income tax.

The Burgess Society is an educational organization chartered to carry on the work of children's author and naturalist Thornton Burgess [1874-1965] "to inspire reverence for wildlife and concern for the natural environment." We maintain the Thornton W. Burgess Museum and the Green Briar Nature Center, both of which are located in Sandwich. We have about 3,000 members in 45 states and host over 120,000 visitors annually.

Ours is a small organization compared to many of this nation's museums and cultural institutions with an annual budget of about $600,000. While our region, Cape Cod, is growing rapidly, it still lacks many of the financial resources of major metropolitan areas. It has no large industries able to provide major support. Few foundations exist that make charitable gifts to institutions in this region. To support itself, the Burgess Society has always relied on its ability to develop other sources of earned income including sales in our gift shops and natural history excursions. Both of these important revenue sources would be severely impacted by the proposed changes in the UBIT law.

Our two gift shops occupy less than 300 square feet each, barely 5% of our total floor space. Great care is taken in the selection of merchandise. Tags and enclosure cards with each item explain the purpose of our organization and the relevance of the item to that purpose. Over 60% of the items we sell are hand-crafted and are not available anywhere else. In short, our

"to inspire reverence for wildlife and concern for the natural environment"

retail shops are an essential part of our educational program and do not compete with area businesses.

Natural history excursions are another important source of support for our organization. Designed for persons with an interest in natural history who want an educational experience, each trip is led by a staff-member of ours or of a kindred organization with appropriate expertise. A great deal of staff time goes into the design of each experience. We provide trips that are decidedly different from those offered by commercial travel agencies and do not compete with profit-making businesses in our region.

Over 100,000 persons visit our two facilities annually. Many of them stay in area hotels, motels or campgrounds, dine at local restaurants, and shop at local gift shops. Far from being detrimental to area businesses, our organization is an important reason for the economic strength of our community.

We feel that activities such as sales in a gift shop or the sponsorship of educational excursions are appropriate to museums and other cultural institutions and in the best interest of the community. To tax income derived from these sources would unfairly impact organizations like ours and force us to an ever-greater reliance on state and federal support or contributions from business, corporations and individuals.

Our nation's museums and cultural institutions should be recognized as a vital part of our social and economic structure. The proposed changes in the UBIT laws would unfairly hinder their development and ultimately do a disservice to our nation.

We would therefore urge the Committee on Ways and Means to reject the proposed changes in the law.

Sincerely,

Robert T. McMaster

Robert T. McMaster
Executive Director

TIMCO
ENGINEERING

TIMCO
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4/7/88

MR. ROBERT J. LEONARD, CHIEF COUNSEL
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
1102 Longworth House Office Building
Washington, D.C. 20515

SUBJECT: UNFAIR COMPETITION FROM NONPROFIT ORGANIZATIONS

DEAR MR. LEONARD:

I again want to voice my strenuous objections to the competition from NONPROFIT ORGANIZATIONS like FLORIDA ATLANTIC UNIVERSITY, GEORGIA INSTITUTE OF TECHNOLOGY, & UNDERWRITERS LABORATORY. These outfits are doing the same type of testing that we do at TIMCO ENGINEERING INC. but we have had to pay taxes, and we have for eleven(11) of the twelve years that we have been in business. The UNIVERSITIES provides "customers" a special benefit in that the "customer" are doing "RESEARCH", which I understand get special tax treatment.

As far "testing for public safety" receiving special treatment, I feel that the testing that we do is also for the public's safety. If a radio device is not tested properly and it later caused interference with a Police or Fire communications network this would definitely cause a public safety problem.

From a personal point of view I think that this form of "tax cheating" is un-AMERICAN. One of the thing that makes us great is that as a group we follow the rules, but bad rules like the one that allow for non=profit competition serve to encourage other to cheat.

I hope you will take time to read this.

SINCERELY,

Sid Sanders,

cc SENATOR BOB GRAHAM
SENATOR LAWTON CHILES
REP. DANTE FASCELL
ACIL

TIMCO ENGINEERING, INC., 14260 S.W. 136 STREET, UNIT #4, MIAMI, FLORIDA 33186

TORCH ENERGY ADVISORS
INCORPORATED
Houston, Texas

Unrelated Business Income Tax ("UBIT") and Proposed Changes Relating to Net Profits Interest

Background

On June 22, O. Donaldson Chapoton, Deputy Assistant Treasury Secretary for Tax Policy, delivered a statement to the Ways and Means Oversight Subcommittee on the subject of UBIT as related to exempt organizations. When dealing with the general subject of royalties, he recommended that consideration be given to narrowing the definition of royalties to exclude amounts measured by net profits. However, he also stated that "in view of the long established practice of treating an interest in mineral property calculated as a net profits interest as an interest in gross production, an exception for such mineral royalties would be appropriate."

More recently, on March 31, 1988, Congressman J.J. PIckle, Chairman of the Subcommittee on Oversight, Committee on Ways and Means, issued a press release listing the Subcommittee's preliminary discussion options regarding UBIT and requesting written comments no later than April 15, 1988. Section IV of the listed options, Tax Treatment of Royalty Income states: "Retain present law for certain non-working property interests and exception for products that are part of the organizations exempt function." We understand that this is intended to leave unchanged the treatment of oil and gas royalties and net profits interests as presently defined by law. Also we understand that Treasury is in agreement with retaining the present law.

We urge that present law be retained as recommended by Treasury. We believe, for reasons stated below, that any change in the treatment of net profits interests would deprive tax exempt investors of a significant alternative area of passive investments and lead to a substantial loss of funds currently needed for drilling activities by the domestic oil and gas industry.

Nature of The Investment

Working Interests are defined in Oil and Gas Law Manual of Oil and Gas Terms, Volume 8, Howard R. Williams and Charles J. Meyers, 1964 as the operating interest under an oil and gas lease. The working interest has the exclusive right to exploit the minerals on the land. The working interest in an oil and gas well is subject to all taxes, operating and other costs and is deemed to be a direct, controlling type of investment and therefore subject to normal income tax. Net Profits Interest is defined as a share of gross production from a property, measured by net profits from the operation of the property. It is "carved out" of the working interest. A Net Profits Interest shares only in a predetermined portion of the revenues after all taxes and operating costs. As such they are treated as passive investments and, for tax exempt investors, are therefore not subject to UBIT.

Importance to The Oil and Gas Industry

Tax exempt organizations have almost exclusively restricted their direct equity investments in oil and gas programs to net profits interests. At the end of 1986, we estimate exempt organization direct investments in oil and gas properties in excess of $1 billion. Our experience in 1987, and that of other similar organizations, leads us to believe that the pension funds, college endowments, and foundations are prepared to make larger investments in future years in an industry desperately in need of capital but only so long as they are not subjected to UBIT. As an example, Torch is investing a $93,000,000 program in producting oil and gas properties, approximately half from exempt organizations committed to acquire net profits interest. All of the exempt organizations have informed us that, should the tax laws change relative to UBIT, they will withdraw from the program.

Equally important is the availability to the domestic oil and gas industry of this type of program as a source of capital. Almost every producing property we have purchased since 1986 has been from an independent oil company or operator the largest portion of which has been used by the sellers to continue drilling operations within the United States. With the banks and public drilling programs no longer sources of funds to the Independent, we believe these production acquisition type programs constitute a major source of drilling funds in today's environment. We are certain that any change in UBIT relative to oil and gas will substantially reduce these investment funds, with the attendant decline in domestic drilling activity and acceleration of shrinking U.S. oil and gas reserves.

Summary

The ability to acquire net profits interests in oil and gas properties is a significant alternative investment vehicle for tax exempt organizations. In addition, it has been and continues to be an important and growing source of capital for the oil and gas industry at a time when other traditional sources have all but disappeared. There is legal precedence, as well as long standing Treasury acceptance, of a net profits interest as a right to gross production measured by net profits. Its elimination will not result in increased tax revenues since exempt investors will divert their investments to vehicles not subject to UBIT. Because of this, and because of its historic legitimacy as an investment vehicle for tax exempt organizations and its importance as a source of capital for the oil and gas industry, we believe that it should remain in its present form and not become subject to UBIT.

19MLPS-E

TRI CITY HEARING AID BATTERY SERVICE
Battery Headquarters
P.O.BOX 116 * MADISON ILLINOIS 62060
Ph (618)877 5333

April 12, 1988

Robert J.Leonard, Chief Councel
Committe on Ways and Means
U.S.House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Mr. Robert J. Leonard
Chief Councel.

Dear Sir:

I am writting you in regards to the unfair practice of non-profit organizations and more pacifically, Hospitals who sell hearing aids which in my estimation are unrelated sales to Hospital Care given to inpatients. The Hospitals and other non-profits, call these people their"Patients" as a cover up, I realize Hearing Aids Are Medical Divices only because they Compensate for the loss of Hearing, however. thev are NOT MEDICINE. The non profits, by their exemption of taxation can sell 24.00 to 30.00 less than the Hearing Aid Dealer becaue the dealer MUST pay taxes while the non-profit down the street sells the same thing but pays NO taxes, this is CHEATING the Goverenment from income tax it could be getting, and working a hard ship on the Hearing Aid Dealers therefore, it will justified if you Applied UBIT TO ALL Hearing aid sales income of nonprofits and also repeal the existing "convenience" exemption for Patients or recognize Patients as in patients ONLY.

This kind of REFORM is long overdue, so lets recognize a Patient as a Patient and a Hearing Aid purchaser as a CUSTOMER OR CLIENT, just because he goes to a Hospital to purchase a Hearing Aid does not make the person a Patient of the Hospital, they still are Customers or clients, this will stop the injustice being did to many small business people all over our country.

Sincerely,

AW Davis

A.W.Davis

TRI-STATE HEARING AID AND AUDIOLOGY CENTER, INC.

239 SOUTH POTOMAC STREET
HAGERSTOWN, MARYLAND 21740
790-0566

Myersville Ext. 293-1490

308 DELAWARE ROAD
FREDERICK, MARYLAND 21701
663-0553

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated business income tax

Dear Sir:

We are a small business providing a variety of services to the hearing impaired. As part of these services, we dispense/sell hearing aids to our patients. Currently a non-profit clinic in our community operating under the County Health & Human Services Department offers the same professional services as those provided by our office. After they do the initial diagnostic evaluation, they have the patient/client send away elsewhere to purchase the hearing aid/s. This means that no one in the clinic has to be State Licensed to sell the hearing aids since this is being purchased elsewhere. Then, the patient/client brings the purchased hearing aid/s back to the clinic where the audiologist in this non-profit setting does the hearing aid fitting and follow-up services. This non-profit organization thus avoids direct profits from the sale of hearing aids but does profit by "coming in the back door" in our opinion.

Our taxes are being used to support this clinic and they in turn compete with us by providing the same professional services connected with hearing aids and a reduced charge to those using those services because our tax dollars are supporting that clinic!

We urge you to apply the UNRELATED BUSINESS INCOME TAX (UBIT) to all hearing aid sales related income of non-profit organizations. There is no doubt that the clinic mentioned above is competing with us on a commercial basis. The people they see are not limited in any way by income and people who might have come to our office for professional services and hearing aid purchases are going there. And, our tax dollars are helping them to continue to operate against us.

We also urge you to repeal the existing "convenience" exemption for patients or that of recognizing patients as inpatients only.

With ever rising costs to continue to do business, it seems incredible that our tax dollars should go to support non-profit institutions who in reality are profiting not only from the sale of hearing aids but from the providing of professional services related to the sale of those hearing aids. Again, we strongly urge you to apply the UBIT to all hearing aid sales and related income of non-profit organizations.

Thank you in advance for your support in helping the private small businesses to be able to continue to function.

Sincerely,

Betty L. Jensen-bjw

Betty L. Jensen, M.A.,CCC-A
President

BJ/bjw

cc: Honorable J.J. Pickle

U.S.
BORDER PATROL
MUSEUM
EL PASO, TEXAS

310 N. Mesa, El Paso, Texas 79901, Phone: (915) 533-1816

April 11, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, DC 20515

Dear Congressman Pickle:

I am responding to press release #16 calling for public comment on the options regarding the unrelated business income tax (UBIT).

I am deeply concerned about the efforts to expand taxation of non-profit organizations' revenue-producing activities. The Border Patrol Museum was founded in 1985 as a privately funded 501(c)(3) museum. Although enthusiastically supported by the INS Border Patrol, the museum receives NO Federal funding. Thus, sales in our tiny gift shop of books, memorabilia, jewelry, and t-shirts unavailable from other vendors provide a significant portion of our operating expenses. We cannot support additional taxation.

This is the nation's only Border Patrol museum and therefore is a national museum. Retired and active officers from around the country order specialty Border Patrol items from the museum's gift shop catalog, thereby generating additional operating funds. UBIT applied to gift shop catalog sales would significantly reduce the museum's income.

As many other non-profit agencies, we rely heavily on unpaid volunteers in all aspects of our operation. The proposed revision of the UBIT will force us to replace our volunteer bookkeeper with a professional, just to compute the additional taxes. This drain on our limited resources would force us to postpone indefinitely our plans to expand our educational programs and our dream of a building of our own.

The 1987 tax code revisions removed many tax incentives for contributions to non-profit organizations, making fund-raising ever more difficult for 501(c)(3) organizations. Expanding the UBIT tax base will harm non-profits once again.

And finally, if the Federal Government removes these tax exemptions for non-profits, the State of Texas and City and County of El Paso stand ready to do the same. Please do not restrict the non-profits' tax-exempt status.

Cordially,

Terrie Cornell

Terrie Cornell, Director

[illegible]

1615 H Street, N.W.
Washington, D.C. 20062
202/463-5602

Albert D. Bourland
Vice President
Congressional Relations

April 14, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The U.S. Chamber of Commerce is pleased to provide the Committee on Ways and Means with its reaction to the discussion options on the unrelated business income tax (UBIT), released on March 31, 1988. We commend the Committee's efforts to clarify the current rules defining unrelated business income and recognize that the complexity of the subject matter, as well as its effect on various segments of a business community with diverse and sometimes competing interests, makes this an arduous task.

The U.S. Chamber of Commerce is the world's largest business federation, and has been the principal spokesman for the American business community since it was formed at the request of President Taft in 1912. It represents approximately 180,000 businesses, trade and professional associations and state and local chambers of commerce, many of whom are affected by one or several of the discussion options.

Specifically, more than 92 percent of the Chamber's members are small business firms with fewer than 100 employees, 59 percent with fewer than 10 employees. We recognize the particular problems of smaller businesses, and support the third recommendation of the White House Conference on Small Business to eliminate unfair competition between for-profit and non-profit entities. We also have long-standing policy that no form of lawful enterprise should be favored by government over any other form, and each should stand on its own merits with protection from unfair competition.

The Chamber also represents approximately 1,200 association members, consisting of both trade associations and professional societies, which, in turn, represent almost all of the major industries and professions. Through these organizations, the smallest and the largest members of industry or the professions can work together for their mutual good. The general public also benefits from their activities, which lead to increased efficiency, improved products and services, better marketing and elimination of economic restrictions and practices. Association activities are generally funded not only by dues payments by members, but also by income generated by programs which may be "related" or "unrelated" to the organization's tax-exempt purpose.

Another major goal of the Chamber is to assist state and local chambers of commerce. There are currently 2,700 state and local chambers within the Chamber membership. As 501(c)(6) organizations, they are directly affected by many of the discussion options. If these options are adopted, many state and local chambers would be forced to decrease the services provided to their members and their communities.

Finally, the Chamber is itself a Section 501(c)(6) organization, and several of the discussion options have a significant impact on the Chamber's own activities.

The difficulties inherent in reconciling the interests of the numerous parties involved in this issue are compounded by the complexity and sheer number of the discussion options presented. While we are pleased to see that many of the issues raised at the previous hearings on UBIT are addressed here, there are a number of discussion options included in the March 31, 1988 request for comments which appear for the first time.

Specifically, the proposal to establish a per se rule requiring the taxation of income from all commercial advertising in journals of tax-exempt organizations is new. Moreover, the proposed change in the advertising cost allocation rule, whereby exempt organizations could deduct from advertising income only those costs directly connected with the sale and publication of advertising, and not circulation expenses, was not raised in the earlier hearings. (This option, in fact, would place exempt organizations at a distinct disadvantage as compared to for-profit entities.) The proposed changes in the allocation rules for deduction of expenses where facilities are used for both exempt activities and unrelated business activities, as well as the proposals to apply UBIT to certain trade shows, income from affinity credit card/mail-order catalog endorsements and royalties also appear for the first time.

Finally, the Chamber is very concerned that the discussion options appear to go further than necessary in order to eliminate unfair competition. For example, it is our understanding, based upon testimony received during the original hearings, that most of the criticism was directed at only a few 501(c)(3) organizations. The discussion options, however, would affect all Section 501(c) organizations, including trade associations, labor unions, social welfare organizations and chambers of commerce. The Chamber believes this far-reaching solution is inappropriate based on the prior testimony.

On the basis of the above, we strongly urge that the Committee provide ample additional time for all of the affected parties to study and fully respond to the Committee's request for comments. We note that the March 31 request provided only a two-week comment period, and that many of the new proposals, if enacted, will significantly affect the Chamber's diverse membership. Additional time for comment would enable us to focus our attention on the new proposals presented in the discussion options and to seek the reactions of our members to them.

The Chamber appreciates the Committee's efforts to reform UBIT. We hope to provide the Committee with further substantive comments based upon a careful evaluation of the discussion options in conjunction with the various segments of our membership who will be affected by them.

Again, we commend your efforts and look forward to continuing to work with you to address this problem. The Chamber appreciates your consideration of its views and requests that they be made part of the record.

Sincerely,

Albert D. Bourland

cc: All Members of the House Committee on Ways and Means

U.S. HEALTH, INC.

ALLEN D. GREIF
Vice-President / General Counsel

April 14, 1988

PUROLATOR

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

Dear Chairman Pickle:

As one of the largest and most progressive profit companies providing fitness facilities to the American public, U.S. Health, Inc., feels that not for profit organizations such as the YMCA should not have an unfair competitive advantage by virtue of the United States tax structure. We therefore respectfully urge the Committee to adopt the following language in place of the Subcommittee's discussion Option I (C):

> "Apply UBIT to income from certain recreational, fitness, exercise and similar activities except for fees received from the so-called charitable classes; i.e., unemployed, senior citizens, military and youth."

This wording would allow for profit facilities such as those we provide, and non-profit facilities such as the YMCA to compete on an equal footing.

Very truly yours,

ALLEN D. GREIF

dc

Corporate Offices
300 East Joppa Road, Suite 703, Towson, Maryland 21204
301/296-8800

THE UKRAINIAN MUSEUM • 203 SECOND AVENUE, NEW YORK, N.Y. 10003 • TEL. 212 228-0110

April 12, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

Our institution is aware that the House Ways and Means Oversight Subcommittee is considering the unrelated business income tax (UBIT) which will adversely effect the income of cultural institutions.

At the Ukrainian Museum we are particularly concerned with the issue of taxing gift shop items. As you undoubtedly know, gift shops generate a fair and vitally necessary amount of income for museums, ours among them. To have that income cut by taxation would be disastrous. It is very difficult to run a cultural organization today considering the severe cut backs in federal and state support, as well as locating funding within the private sector.

We strongly urge members of the Committee to reconsider supporting this measure.

Very truly yours,

Maria Shust

Maria Shust
Director

MS:mb

UNDERWRITERS LABORATORIES INC.
[illegible] PFINGSTEN ROAD · NORTHBROOK, ILLINOIS [illegible]
an independent, not-for-profit organization testing for public safety

COMMENTS OF UNDERWRITERS LABORATORIES INC. (UL) ON DISCUSSION OPTIONS RELATING TO THE UNRELATED BUSINESS INCOME TAX (UBIT)

April 13, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, DC 20515

Subject: Discussion Options Relating to the Unrelated Business Income Tax (UBIT).

Dear Mr. Leonard:

Underwriters Laboratories Inc. (UL) herein submits comments in response to the request for comments by the Oversight Subcommittee of the House Ways and Means Committee on Discussion Options Relating to the Unrelated Business Income Tax (press release dated March 31, 1988).

The option to which UL responds is recorded as follows:

X. Modify rules applicable to organizations "Testing for Public Safety."

Additionally, Discussion Option I.H. of the same text addresses "Routine Testing." Based on input from the subcommittee staff and review of IRS Revenue Rulings 85-109 and 85-110, we understand that this item deals with currently taxable testing activity and is intended to codify the current law. If, however, "Testing for Public Safety" is ever to be considered in this vein, our comments outlined below are applicable to this Option as well.

UL is an independent not-for-profit organization which, in the interest of public safety, has, for almost 100 years, directed its entire efforts to protection of life and property. UL has provided invaluable services to society in the field of public safety - services which, if not performed by UL, would either have been left to Federal, state or local governments or, if not performed at all, would have resulted in significantly increased risks to the lives and property of American consumers.

UL has continuously adhered to its public safety mission. At the initial hearings, two members of the profit-making laboratories stated that they are competing with UL in safety testing, but in fact UL's activities are far more comprehensive and fundamentally different than those of commercial laboratories. Additionally, it is the profit-making laboratories who have in recent years begun to pick and choose certain income-producing elements of the traditional UL safety work leaving most of the voluntary and non-income-producing activities to UL. Unlike most of the allegations in the UBIT issue, in almost every instance, it is the profit-making laboratories who have chosen to encroach on the work which UL has carried out for many years, even using UL-developed standards and engineering procedures for this purpose.

When UL's tax exemption issue became a matter for consideration by the Oversight Subcommittee, UL prepared a Statement of its position and placed it in the hands of designated staff and each Congressman of the Subcommittee. A copy of this Statement citing the reasons in support of continuation of the "Testing for Public Safety" exemption is attached and should be considered as part of UL's response. The key issues addressed in the Statement are outlined below as a brief review:

... UL was founded in 1894 for the express purpose of reducing bodily injury, loss of life, and property damage -- UL has never departed from this mission.

... UL, as a membership corporation without capital stock, is uniquely structured to respond to public safety needs.

... UL is an integral part of an established United States public safety system.

... UL provides unique services in carrying out its responsibilities as an integral part of the United States safety system. Some of these non-income-producing responsibilities include product safety standards development, contribution to the formulation of international standards and their harmonization with U.S. standards, supplying assistance to federal, state and municipal authorities, participation in Code-Making activities, provision of educational safety materials and information, and conduct of essential and timely safety research and assistance to U.S. manufacturers in obtaining acceptance of products in other countries.

... Profit-making laboratories do not provide this complete program. They choose only the income-generating elements. Some do testing. Some conduct factory inspections. Only UL provides the complete program, including services for which no income is derived because all elements are necessary for the safety role UL is required to play.

... UL's tax-exempt status has been a contributor to its ability to develop resources (including facilities and instrumentation) required to meet the demands of high technology and to maintain UL's role as a viable institution.

... The recommendation that UL's tax exemption be withdrawn is based on false premises.

In conjunction with this last point, UL prepared a rebuttal to the testimony of the two representatives who testified at the hearing and this statement is included as a part of our submittal.

The significant points in the rebuttal statement are:

... The two instances of alleged UL involvement in non-safety work cited by one of the witnesses are both in error. As with all of UL's work to date, the activities are directly related to safety.

... UL was organized as a non-profit organization and was tax exempt until 1935 as an organization operating for scientific purposes. When the IRS ruled that UL did not fit the normal scientific category and removed the tax exemption, UL paid taxes until 1954, at which time UL was specifically excluded from paying taxes by Congressional action in including the "Testing for Public Safety" exemption in the Code.

... Contrary to the assertion by one witness, UL differs in fundamental ways from commercial laboratories whose objective is profit oriented.

... UL's testing of electronic products to determine electromagnetic interference is directly related to safety.

... UL is not engaged in "unfair competition." Because of the need to carry out many non-income-producing activities as part of UL's product safety certification, UL must generate income from the engineering and follow-up inspection areas to support these non-income activities. Laboratories which do not provide all of the services are free of those costs.

SUPPORT FOR UL'S POSITION

UL uses the "Testing for Public Safety" exemption well. Many organizations are directly assisted by UL staff involvement, technical expertise and safety research, including agencies of the Federal Government, state and local officials, academia, professional groups, consumers, and industry. This assistance is expected of UL as part of UL's product safety certification responsibilities and it is provided unstintingly without cost in accordance with our public safety mission.

One Congressman expressed an interest in hearing from the beneficiaries of UL's efforts. We contacted approximately 20 such groups, representing a cross-section of those we serve, and asked that they express to the Congressman, as well as the Chairman of the Oversight Subcommittee, important ways in which UL's contributions specifically benefited their organizations or industries in providing for public safety. Over 20 letters were written, including letters from three government agencies, an association of 15,000, state and municipal electrical inspectors, and an association of 40,000 members with an interest and involvement in fire safety. A listing of respondents is attached to this letter. Excerpts from these letters are included as an Exhibit. UL is confident that the number of letters could be 200 or 2,000 if additional proof is needed of UL's interrelationship with, and support for, others who make up the U.S. safety system.

The UBIT issue has been characterized as small business versus non-profit institutions. In this respect, it should be pointed out that thousands of both small and large business organizations benefit from UL's comprehensive programs and we believe would oppose any reduction in UL's safety efforts.

"TESTING FOR PUBLIC SAFETY" ENCOMPASSES A COMPREHENSIVE PROGRAM KNOWN AS PRODUCT SAFETY CERTIFICATION

The "Testing for Public Safety" exemption in the law was adopted in 1954 specifically for UL's program of product safety certification. In fact, "Testing for Public Safety" was then, and still remains, UL's motto and masthead.

The program is required to be very comprehensive in order to satisfy the needs of regulatory authorities and others who rely on UL Marks which appears on over six billion products annually. In outline form, these are the elements of the program:

... Engineering investigation - to determine compliance of the product with UL standards.

... Follow-up inspection at factories - to determine that production continues to comply.

... Development of standards - 540 product safety standards produced and maintained to date, approximately 80% of which have become American National Standards.

... Protection and control of the distinctive UL Mark.

... Active participation in development of codes and installation standards.

... Representing U.S. views in international standards development.

... Harmonization of U.S. and international standards to promote trade.

... Educational efforts aimed at consumers and users.

... Support to federal, state, and municipal authorities.

... Conduct of essential and timely research - to develop needed safety information and protocols for safety evaluation of products.

... Formation and use of forums for involved safety individuals.

Almost all of UL's income is derived from two of these elements - the engineering investigations and the factory follow-up inspections. This income supports all of the remaining activities. If UL's income is reduced by a need to pay taxes, the effect will be a reduction in the non-income-producing public safety activities which UL carries out. For example, over six million dollars was spent on development and maintenance of standards in 1987.

The important point to be made in this discussion is that "Testing for Public Safety" is far more than "Routine Testing." It was meant, in 1954 when the law was revised by Congress, to designate the product safety certification program of UL.

There are a few profit-making laboratories that provide engineering and a form of follow-up inspection on products covered by UL standards. There are none that provide the elements previously outlined. This is understandable since these additional elements basically produce no revenue.

THE FEDERAL GOVERNMENT IS RELIEVED OF SIGNIFICANT EXPENSE BY UL'S ASSUMPTION OF ESSENTIAL SAFETY FUNCTIONS

A number of functions of the type carried out in whole or in part by UL are, in other countries, totally or partially financed or totally assumed by the Federal Government. For example:

... Development and publication of national safety standards.

... Development of installation codes (building, structural, electrical, etc.).

... Staff participation in international standards committees.

... Conduct of safety research.

... Harmonization of national with international standards.

... Development of international programs to reduce or eliminate trade barriers in the form of safety requirements and acceptance of test data.

... Education of consumers and users in public safety matters.

If the U.S. government were to absorb the cost of these activities, as is done in many other countries, it would substantially exceed the four million dollars or less that may accrue to the government by taxing the net income of UL.

Additionally, considerable assistance is provided at no cost by UL's safety experts to the Occupational Safety and Health Administration, U.S. Consumer Product Safety Commission, Department of Defense, General Services Administration, U.S. Coast Guard, U.S. Trade Representative's Office, and other federal agencies. The Federal Government and the public are benefited by the existing wise policy of exempting "Testing for Public Safety" organizations.

Providing this assistance to the Federal Government has been a long-standing policy of UL. UL has treated this policy as an obligation resulting from the unique role it plays in the United States safety system.

UL'S PRODUCT SAFETY CERTIFICATION PROGRAM SHOULD CONTINUE TO BE EXEMPT FROM FEDERAL TAXATION

For the reasons included in this letter, amplified and added to in the attachments submitted with this letter, the exemption for "Testing for Public Safety" should continue. The impact on public safety of the elimination of this exemption would be significant and negative. It would certainly impede UL's ability to respond to the need for safety evaluation of new and innovative products in today's fast paced technologically changing environment. Also, in the for-profit environment there will always be that temptation to reduce the commitment of funds and efforts which presently allow UL to perform many significant and positive public-interest activities. Congress, on the contrary, should encourage UL and others to contribute to vital areas of public safety.

UL deserves its status because it occupies a unique role in the safety system in the United States, a role that includes a comprehensive program with responsibilities not assumed by any profit-making laboratory. Any reduction in UL's ability to carry out these safety responsibilities will result, in our view, in the need for the Federal Government to assume them or, more unfortunately, a reduction in public safety. This view is shared by others in the safety community, as expressed in letters previously referred to and which can be made available to additional Congressmen or their staffs.

ALTERNATE CONSIDERATION

All of UL's work to date is in the public safety area and should continue to have tax-exempt status. This is UL's position as expressed in this letter. However, in discussions with the staff of the Oversight Subcommittee, it was suggested that UL consider alternatives to this fixed position.

Not all of UL's safety engineering investigations are specifically associated with determining compliance with safety standards and the subsequent authorizations to use the UL Mark. Some funded services are directly related to safety but are not associated with the certification of a product. Examples are:

... Certain amount of research conducted by UL that is funded by government and industry to develop information pertaining to specific hazards, such as fires in nuclear facilities, flame propagation in mobile homes, and automatic sprinkler protection for fires in high piled stock.

... Data development for specific properties of products or materials of importance to regulatory authorities or manufacturers but not involving products that are to be certified and identified with a UL Mark. Two such examples are investigations to determine the toxicity of combustion products from certain materials and certain determinations of electromagnetic interference of electronic devices. (Some of the latter determinations are applicable to certification of products used in fire and burglar alarm systems.)

... Determination of compliance of products from U.S. manufacturers with national safety standards of other countries to assist in gaining acceptance of those products by authorities in such countries.

... Investigations carried out in constructed buildings to ascertain safety hazards of installed systems and products in such buildings.

These safety activities do not require or conclude with the authorization for use of a UL Mark on a product. They do not, therefore, fall in the category of product safety certification, although they definitely are in the interest of public safety.

These activities normally do not demand the development of standards so they are free of this financial burden. They do not necessitate carrying out some of the other elements of product safety certification. This type of safety work can be carried out by other laboratories who do not provide all the elements of product safety certification, if appropriate staff and experience are available.

If the Committee wishes to more specifically define the tax exemption for public safety, consideration might be given to amending the law to define "Testing for Public Safety" as "Product Safety Certification." Although interpretations of this term exist nationally and internationally, the practical application in the important area of public safety that has served our nation well for many decades can be best defined generically as follows:

... "Activity carried out by not-for-profit independent organizations certifying products for public safety by conducting appropriate tests and factory follow-up and inspection services on such products, providing for the application of a controlled product Mark, developing and/or utilizing product safety certification standards, participating in the generation of installation codes, carrying out publicly responsive safety studies, using and bringing about the harmonization of U.S. and international standards, and providing public safety educational services."

What would this change do? The exemption would be more generic rather than specific to UL. It would more precisely cover the activities which require UL to assume many non-income-producing responsibilities. It would permit other non-profit organizations engaged in product safety certification work on an equal or similar basis to qualify for the exemption. It would require UL to pay UBIT on work which falls outside of the product safety certification area. It would, perhaps, address the concerns of those profit-making laboratories which concentrate their efforts to testing without providing services and assuming responsibilities (standards development, assistance to governmental agencies, international standards, distribution of safety information, etc.) which are required of a reliable product safety certification program.

Finally, although UL's tax exemption would be restricted, as compared with its previous status, it would not require abandonment or major reduction of those programs conducted in the interest of public safety.

I would like to take this opportunity to request that UL be permitted to testify on this issue at the upcoming Subcommittee hearings. I, accompanied by Joe Bhatia, Assistant to the President - Governmental Affairs, will represent UL.

Very truly yours,

Jack Bono

JACK BONO
President
Underwriters Laboratories Inc.

JAB:BRM

Attachments
  Exhibit 1
  Exhibit 2
  Exhibit 3

LETTERS FROM ORGANIZATIONS SUPPORTING UNDERWRITERS LABORATORIES INC. AND "TESTING FOR PUBLIC SAFETY"

1. U.S. Consumer Product Safety Commission (CPSC)
2. U.S. Coast Guard (USCG)
3. Office of the U.S. Trade Representative
4. State of North Carolina, Department of Insurance
5. National Fire Protection Association (NFPA)
6. International Association of Electrical Inspectors (IAEI)
7. Council of American Building Officials
8. University of Maryland, College of Engineering, Fire Protection Engineering
9. Society of Fire Protection Engineers (SFPE)
10. National Electrical Manufacturers Association (NEMA)
11. The St. Paul Companies, Inc.
12. Jasper S. Hawkins, F.A.I.A.
13. Leviton Manufacturing Company, Inc.
14. Cooper Industries
15. Crouse-Hinds Electrical Construction Materials
16. Square D Company
17. Pass & Seymour
18. E. I. du Pont de Nemours & Company
19. National Electrical Contractors Association (NECA)
20. AT&T Bell Laboratories
21. J. C. Penney Company, Inc.
22. Challenger Electrical Equipment Corporation

[EXIBITS SUBMITTED WITH THIS STATEMENT ARE BEING RETAINED IN THE COMMITTEE FILES.]

United
Hospital Fund

Shaping New York's Health Care:
Information, Philanthropy, Policy

55 Fifth Avenue
New York, NY 10003-4302
212 645-2500

April 15, 1988

Honorary Chairman
of the Board

Officers

Congressman J. J. Pickle
Chairman, Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Unrelated Business Income Tax: Response to Discussion Options

Dear Mr. Chairman and Members of the Subcommittee:

On behalf of the United Hospital Fund of New York, I would like to respond to your request for comments on the discussion options released by the House Ways and Means Oversight Subcommittee on March 31, 1988. But first I have some general comments which we feel are of paramount importance.

We feel it is very important that before a whole host of technical changes are implemented, their possible intended and unintended ramifications be studied and understood. For example, when changes are proposed that could result in large scale loss of exemptions for voluntary institutions such as our nation's voluntary hospitals, as could be the case under the proposed changes and the aggregation rule, the Committee should seriously consider whether the result would be wise and intended. Certainly, policy regarding the unrelated business income tax should not be made in a vacuum, and should be made in a manner that is consistent with other public policies.

Some of our nation's public policies with regard to hospitals, which are grounded in the government's legitimate role in protecting the public's health, and which have been ennunciated by legislators on both the local and federal levels, have long urged our voluntary charitable hospitals to branch out from the traditional four walls of the inpatient acute care hospital and to provide a richer and broader continuum of care for its patients and for their communities. In responding to this governmental and societal request, many hospitals have chosen to undertake some of these activities using various corporate forms, including subsidiary arrangements. Part of the logic behind encouraging hospitals to provide a broader continuum of care is to avoid the overlaps and inconsistencies that can occur when health care is provided in a fragmentary, disjointed basis. We think that this is a sound policy and that changes in the tax law that would not only discourage this activity but which would also cause the parent institution to lose its tax exemption is just plain bad public policy and inconsistent with other stated goals.

Also, it was the strong consensus from almost everyone who testified before your Committee last summer that the alleged abuses, if any, of the unrelated business income tax law were at best related by anecdote and rumor, and that careful study and inquiry was needed to provide the data upon which sound decision making could be made. Almost everyone endorsed these studies, and it would appear illogical to move ahead with specific recommendations in the absence of that information.

More specifically with regard to the March 31 memorandum, I would like to provide the following comments:

I."Substantially Related" Test

It is indeed difficult to comment on the proposal to change from the "substantially related" test to a "directly related" test when no workable definition or concept of what the difference is between the two is offered. One would presume that the "directly related" test would be a stricter one, but it is difficult to see how mere changes in the words alone would make the task inherently easier. We believe, instead,- that the "substantially related" test is still workable, and should be retained. I would also point out that the Department of the Treasury in its testimony provided by Deputy Assistant Secretary of the Treasury, O. Donaldson Chapoton, on June 22nd 1987, reached exacly the same conclusions.

Furthermore, we feel that it is logically unsound to promulgate a specific list of activities that would be deemed to be "inherently commercial" for the purposes of this tax. The Committee should not lose sight of the fact that in the world of public charities it is not the mere transaction itself that is determinative of its nature, but rather the context within which it is undertaken and the intent involved on the part of the organization. In addition to being dangerously vague, we feel that any specific list of "inherently commercial" activities could become highly political and subject to subjective interpretation, selective enforcement, and inequity.

II. The Convenience Exemption

. We disagree with the discussion paper that the exemption granted to income earned from activities carried on primarily for the convenience of exempt organizations' members, students, patients, officers, and employees, should be repealed. It is not entirely clear to us what the intent or reasoning behind this proposed change is, for it is hard to conceive that the tax income generated by these services is significant. However, if the intent is to do harm to the public charities' ability to serve their communities by effectively reducing the level of services they can provide, then the rule would appear to be rational. However, I hope that is not the Committee's intent.

III. "Regularly Carried On" Test

Also included in the discussion paper was a proposal to repeal the requirement that an otherwise unrelated activity be one that is "regularly carried on" before the income it creates will be taxable under UBIT. Again, one strains to see the underlying conceptual framework that would argue in favor of such a change. One clear impact that this change would have, however, would be to inhibit or curtail many of the occasional fund raising efforts upon which public charities so often rely.

IV. Royalty Income

Once again, this is an area where the Treasury Department's own recommendations call for further investigation, in advance of any proposed changes,to ascertain whether there are indeed any abuses of the use of royalty income which would require rectification. If it can be effectively and objectively demonstrated that there are indeed such abuses, we would be among the first to recommend corrective action.

V. Deduction From Taxable UBIT

We wholeheartedly concur with the proposal to increase the specific UBIT deduction to $5,000 from $1,000. It has been 38 years since this law was enacted, and an increase of this magnitude, although modest, is warranted. Similarly, we agree with the proposed phaseout of the deduction beyond the level of $50,000 dollars in income, so that the law will act as it was intended, to the benefit of small unrelated businesses.

VI. Unrelated Debt-Finance Income

The Committee has proposed to restrict the exemption from UBIT granted for income from debt-financed property to only pension funds, education institutions, and title holding companies that make at least a 20% equity investment of their interest in the property. In the absence of an expressed rationale for either this change or for the 20% figure, we remain unpersuaded.

VII. Subsidiaries and Joint Ventures

As our organization expressed to the Committee in our testimony last June, and in follow-up commentary requested by the Committee, we feel that these areas are among the most complex for public charities and for the tax law. For those reasons, we agree with many of the others who testified that careful study and analysis should be undertaken in advance of any proposed changes. For example, we feel very strongly that changes in the aggregation rule which would attribute to the parent all of the activities of its taxable subsidiaries for the purposes of determining the primary purpose of the parent, could have an overly broad impact, causing many institutions to lose their exempt status altogether. Unless this is the real intent of the Committee, we urge that such an extreme proposal be reconsidered.

VIII. Allocation Rules

With regard to proposed changes in the rules by which proportionate shares of operating cost or overhead can be deducted from income of otherwise taxable subsidiaries, we agree with the Treasury Department's own recommendations to your Committee that a more practical method of allocation needs to be developed. Unlike the proposal's recommendation to approach this topic on an item by item basis, we feel that it would be more logically sound to address the issues of when and under what circumstances any items would be deductible.

IX. Reporting and Information

We concur with the Committee that better information and reporting may be required in the area of unrelated business income tax, specifically regarding the IRS Form 990-T. Also, the idea of "short form" method for reporting by smaller organizations makes sense to us.

Thank you for the opportunity to present our views.

Sincerely,

Bruce C. Vladeck
President

cc: J. David Seay

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April 14, 1988

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

The United Ostomy Association, representing the concerns and interests of an estimated 700,000 Americans who have had ostomy surgery, wishes to offer the following comments for consideration during deliberations relating to **Unrelated Business Income Tax:**

o The United Ostomy Association, like many other voluntary health organizations, depends largely on dues from its members, or on contributions raised through a variety of fund raising efforts. (We are not, and have never been, the recipient of federal, state, or local financial assistance.) To have such income taxed, and the net proceeds thereby lessened, we would have to consider some heretofore undesirable alternatives such as increasing dues to our members, a large majority of whom are senior citizens on fixed incomes. Please **consider the application of special exemptions to non-profit voluntary health organizations.**

o The application of Unrelated Business Income Tax to catalog or mail order items would impose a serious fiscal penalty on our association. Our patient education publications represent the bulk of such sales, publications which are, with few exceptions, unavailable through other channels. With a membership of 44,000 spread across the United States, very few of whom have physical access to our administrative headquarters, we must rely exclusively on "off-premises" sales of our educational literature, material which in itself directly relates to furtherance of our goal of rehabilitating persons with ostomies. Please consider **exempting such patient-oriented publications, whether from the UOA or from other health-related organizations.**

o The taxation of all net income from advertising will negatively impact our ability to continue cost-effective publication of our quarterly magazine, which provides patient education material as well as information about ostomy management equipment (in the form of advertising by manufacturers and distributors). The magazine is the chief concrete membership benefit provided, and contains patient-oriented information unavailable through any other channel; increased taxation of advertising income would inevitably require increasing dues to our members.

36 EXECUTIVE PARK · SUITE 120 · IRVINE, CALIFORNIA 92714 · (714) 660-8624

26th Annual Conference, July 13-17, 1988, New Orleans, Louisiana o We are uncertain about the impact of other extensions of the unrelated Business Income Tax on our association.

- Would taxes be imposed on the income we receive from trade organizations which exhibit at our regional and national patient education conferences? This income currently goes to defray the expenses associated with mounting displays of new advances in ostomy management equipment, for the benefit of conference attendees. A net reduction of exhibit income would result in higher registration fees.

- Would taxes be imposed on contributions from our affiliate chapters, and other individuals, made to sponsor "advertisements" in educational conference program books? These contributions are used to defray the costs associated with the program book and general conference expenses; taxation would reduce the net contributions, necessitating increased registration costs -- again to our largely senior citizen group.

Our organization has, for 26 years, prided itself on being fiscally self-reliant. We have used our member resources exclusively to accomplish our goals, and feel that we were exemplary in this respect, well in advance of the recent move toward greater reliance on the voluntary sector for the accomplishment of society's goals. Due to the unique nature of the service we provide, to a segment of society largely unserved by other facets of the medico-political realm, we feel that the application of the above-mentioned Unrelated Business Income Tax extensions would seriously handicap our ability to achieve our goals. This is equally true of similar voluntary health organizations.

Thank you for this opportunity to comment to the Subcommittee on Oversight on matters being considered. Should further information be desired, please contact me in care of our Irvine, California office.

Sincerely,

Linda K King

Linda K. King
Secretary
Chairman, Government Affairs Committee

CC: Kenneth W. Aukett, President
Darlene A. Simmers, Acting Executive Director
Members, Committee on Oversight

UNITED STATES CATHOLIC CONFERENCE
1312 MASSACHUSETTS AVENUE N.W., WASHINGTON, D.C. 20005 (202) 659-6690

Office of General Counsel

April 15, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

The United States Catholic Conference ("USCC") submits these comments in response to your March 31, 1988 request for public comments on the Subcommittee on Oversight's options relating to unrelated business income tax ("Press Release #16").

USCC is a nonprofit membership corporation of which all active Catholic bishops of the United States are members. USCC promotes the pastoral teachings of the bishops in such diverse areas as education, social welfare, health and hospitals, youth activities, communication, family life, and immigration and refugee assistance. USCC is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986 ("Code"), and holds a group tax-exemption ruling, reaffirmed annually, that establishes the exemption under section 501(c)(3) of thousands of Catholic organizations listed in the Official Catholic Directory ("Group Ruling").

USCC does not file Form 990-T, because historically it has avoided any activities that would give rise to unrelated business taxable income. Like other exempt organizations, entities covered under the USCC Group Ruling are obligated to file Form 990-T with respect to unrelated business taxable income in excess of $1000. However, USCC possesses no information on the number of such organizations currently filing Form 990-T.

These comments address the Subcommittee options (as they have been numbered by the staff in its Press Release) that would affect USCC directly, and also identifies those that are likely to affect Catholic institutions covered under its Group Ruling adversely. Options affecting specialized interest groups, e.g., Catholic hospitals, Catholic universities, and Catholic newspapers, can be expected to be addressed by those groups directly.

I. "Substantially Related" Test:

USCC supports retention of the "substantially related" test as it exists under current law. The body of law and interpretation that has developed under the existing standard is a satisfactory guide for both the government and the exempt organization community in determining whether an activity constitutes unrelated trade or business. No serious objections have been raised with respect to the existing standard. Adoption of a new standard would introduce unnecessary confusion and uncertainty in this area of the law. The existing "facts and circumstances" approach recognizes IRS expertise developed over almost 40 years of regulation, and accords appropriate deference to IRS administrative discretion.

If particular abuses can be identified and documented, the proper approach would be to amend discrete portions of the statute rather than to insert a new standard whose meaning would necessarily remain unclear. With this recommendation in mind, we will address some of the items on which imposition of UBIT is recommended on account of their "inherently commercial" nature and scope.

A. Application of UBIT to gift shops and bookstores should be limited to organizations in which abuses have been documented. Sales of religious documents, books, pamphlets and the like are an integral part of the proseletizing mission of religious denominations. USCC is particularly concerned with the option to impose UBIT on income from all catalog and mail/phone order or other "off-premise" sales. Imposition of tax on such sales could seriously handicap the Church's legitimate mission to educate its members on doctrinal matters and to spread the Gospel message in the public arena generally.

In 1987, USCC's Office of Publishing and Promotion Services filled 26,894 orders, representing 572,459 books or other documents shipped. These publications were primarily sold through phone and mail orders, since USCC does not maintain an on-premises bookstore. Publications sold through the OPPS catalog, a copy of which is attached, include official papal documents, Vatican II documents, statements of the U.S. bishops on numerous pastoral and social justice concerns, adult religious education materials, documents relating to ecumenical dialogue, and materials for youth and young adult ministry.

Generally, concerns regarding gift shop and bookstore sales have been focused on universities, museums, and hospitals. Without making any judgments on the validity of such concerns, USCC urges the Subcommittee to limit restrictions in this area to documented abuse cases and not cast too wide a net to encompass activities clearly related to legitimate purposes, long recognized as exempt. Such an extension could be viewed as an attempt to undermine the tax exemption of churches generally by taxing their proseletyzing efforts. Such a result would be contrary to constitutional principle and sound public policy.

B. Application of UBIT to all advertising in exempt periodicals would adversely impact Catholic publications that rely upon advertising revenues for support. Some advertising in such publications is commercial and properly subject to UBIT. However, in a typical Catholic newspaper serving one of the 185 Catholic dioceses nationwide there is substantial advertising content considered to be related to exempt purposes. Such advertising might include ads for Catholic elementary and secondary schools in the diocese, Catholic cemeteries, retreat facilities, and the like. Subjecting income from such advertising to UBIT and altering the advertising cost allocation rules could reduce the revenues available to support such publications.

II. Convenience Exception:

Repeal of the convenience exception would subject to UBIT income from activities that are carried on primarily for the convenience of an organization's members, students, patients, officers, or employees. This exception historically has been relied upon to remove from the scope of UBIT, hospital and employee cafeterias, on-site day care centers, etc. The Subcommittee's options indicate that income from activities that are substantially related would remain tax free subject to the rules listed in Section I of the Press Release. There is an overlap between activities covered by the convenience exception and those that are related to exempt functions.

It is not clear that documented abuse situations exist with respect to the convenience exception. However, if the exception is repealed, USCC urges that such activities as hospital and employee cafeterias and such activities as on-premises day care facilities be identified clearly as related to exempt functions. Providing on-site eating facilities and convenient day care facilities contribute importantly to employee morale and consequently to the efficient operation of the exempt organizations providing such services. Taxing the income from such facilities is a disincentive to their operation. At a time when the national need for quality child care is reaching crisis proportions, taxing income from on-site facilities of tax-exempt organizations would be contrary to sound public policy.

III. "Regularly Carried On" Test:

If the "regularly carried on" test were to be repealed all income from unrelated trade or business would be subject to UBIT regardless of the regularity with which it is conducted. Such repeal could adversely affect numerous fundraising activities of Catholic organizations, unless such activities were not trades or businesses or if they were subject to the exceptions for volunteer labor or donated goods exceptions. The concerns that generated inquiries regarding UBIT over the past few years relate to unfair competition. The existing test recognizes these concerns. If a trade or business is not regularly carried on it is difficult to understand how it presents a case of unfair competition with commercial business, which by definition is regularly carried on. The existing regulations provide that an activity is regularly carried on if it exhibits frequency and continuity and is pursued in a manner generally similar to comparable commercial activities. Where it is carried on in a different manner by a tax exempt organization, it should not be taxed.

V. Deduction from Taxable UBIT:

USCC would support increasing the $1000 UBIT deduction to a reasonable level to take into account inflation that has occured since it was enacted. The Form 990-T filing threshhold should be raised to the same amount.

VII. Taxable Subsidiaries and Joint Ventures:

USCC recognizes the difficulties IRS has faced in the past several years in interpreting statutory rules that were not designed to deal with the situations posed by exempt organizations having numerous taxable subsidiaries or serving as general partners in commercial ventures, notably in the health care area. In recognition of IRS's legitimate concerns in this area, USCC has instructed Catholic hospitals covered under its Group Ruling that newly created entities established as part of a Catholic health care system may not establish exemption through the Group Ruling process, but must file Form 1023 with IRS and establish independent exempt status. This agreement with IRS was designed to protect the integrity of the USCC Group Ruling and to provide IRS the opportunity to review the activities of reorganized health care systems, to satisfy itself of the legitmacy of their reconstituted operations.

Although USCC does not serve as the primary representative body for Catholic health care systems, the proposed options would adversely impact these systems to the extent that they have relied upon current IRS interpretations in restructuring and dealing with their subsidiaries, both exempt and taxable. In general, the focus of this section of the Press Release on redefinition of controlled subsidiaries, aggregation of exempt organizations in determining control, establishing minimum tax levels for taxable subsidiaries, and aggregation of the income and activities of controlled subsidiaries, may be misplaced. Instead, the focus should be on specific areas in which tax-exempt funds are or may be used to subsidize taxable subsidiaries. Such subsidies might include initial or ongoing capital contributions to taxable subsidiaries, unreimbursed or under-reimbursed services or facilities provided by tax-exempt entities to taxable subsidiaries, or volunteer labor provided to taxable subsidiaries by or through an exempt parent organization. Each of these situations represents a form of competitive advantage to taxable subsidiaries of exempt entities that is not available to commercial counterparts. The Subcommittee's effort should be limited accordingly.

VIII. Allocation Rules:

USCC would oppose the option to limit deductions from UBIT to direct operating costs. A proportionate share of the general overhead and depreciation should also be permitted.

IX. Tax Information Reporting/IRS Administration:

USCC would support additional information requirements on IRS Forms 990 and 990-T, provided the additional information is reasonably related to legitimate IRS concerns regarding abuses in the UBIT area. However, USCC would oppose any changes in the existing mandatory and discretionary exemptions from the Form 990 filing requirements under section 6033 of the Code.

X. Miscellaneous:

The Subcommittee options contain a final "catch all" item suggesting modification of various piecemeal UBIT exclusions that have been enacted since 1969. Without engaging in detailed discussion of these modifications, repeal of the following exceptions would adversely impact Catholic institutions: volunteer labor, donated merchandise, cooperative hospital service organizations, rental of mailing lists, distribution of low-cost articles, income from certain broadcasting activities, and, last but not least, bingo. Many of these exceptions are relied upon for fundraising by Catholic institutions. Repeal of the UBIT exceptions for such activities would reduce revenues available for numerous worthwhile exempt activities.

In general, much could be achieved through increased enforcement by IRS. Beyond that, wholesale changes in the statutory framework have not been justified. Only in cases of demonstrated serious abuse should consideration be given to unraveling the fabric of UBIT as it has evolved.

Sincerely,

Mark E. Chopko

Mark E. Chopko
General Counsel

Deirdre Halloran

Deirdre Halloran
Associate General Counsel

[ATTACHMENT SUBMITTED WITH THIS STATEMENT IS BEING RETAINED IN THE COMMITTEE FILES.]

USLL
UNITED STATES LEAGUE of SAVINGS INSTITUTIONS WASHINGTON OFFICE
1709 NEW YORK AVENUE, N.W. / WASHINGTON, D.C. 20006 / TEL. (202) 637-8900

COLEMAN C. O'BRIEN
Senior Vice President and
Legislative Counsel

April 15, 1988

COMMITTEE ON
RECEIVED
APR 15 1988
WAYS AND MEANS

Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Pickle:

The United States League of Savings Institutions* is concerned that enactment of the Subcommittee discussion options concerning unrelated business income (UBI) would cause significant hardship to tax-exempt organizations which are operating properly under the current tax laws, and that legitimate non-profit organizations would be severely disrupted in pursuing their exempt purposes.

Aggregation

Under our country's legal traditions, a tax-exempt organization, as any other organization or company of whatever kind, may invest in the stock and create separate, taxpaying corporate subsidiaries to carry on for-profit activities. However, the discussion options suggest that activities of a tax-exempt organization should be aggregated with those of its separate corporate subsidiaries of which it owns the stock for purposes of determining whether the exempt organization continues to qualify for tax-exempt status.

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* The U.S. League of Savings Institutions serves the more than 3,000 member-institutions which make up the $1.2 trillion savings association and savings bank businesses. League membership includes all types of institutions -- federal and state-chartered, stock and mutual. The principal officers include: Theo H. Pitt, Jr., Chairman, Rocky Mount, North Carolina; B. R. Beeksma, Vice Chairman, Oak Harbor, Washington; William B. O'Connell, President, Chicago, Illinois; Philip Gasteyer, Executive Vice President and Director of Washington Operations; Coley O'Brien, Senior Vice President and Legislative Counsel; and Brian Smith, Senior Vice President, Regulatory Operations. League headquarters are at 111 East Wacker Drive, Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

We oppose this proposal because it could cause an exempt organization to forfeit its exempt status and thereby result in the imposition of tax on all of its income, including tax exempt dues for which the exempt organization was granted exemption so that the organization can carry out its tax exempt purposes. This proposal addresses no actual abuse and could actually restrict competition rather than foster it.

During the hearings of the Subcommittee, a main proposal has been that exempt organizations should not be permitted to engage in businesses unrelated to their exempt functions without paying taxes on the same basis as their for-profit competitors. This is fully met by legitimate non-profit organizations, because under the present law there is an imposition of tax on the income of for-profit subsidiaries, and this does not necessitate taxation of the exempt parent as well. Under present law the income of separately organized for-profit subsidiaries is fully taxed, and under these circumstances there can be no justification for placing in jeopardy the exempt status of exempt organizations acting in good faith to accomplish their exempt purposes, and which also have for-profit subsidiaries which pay all of the tax due on any unrelated activities which are carried on by the for-profit subsidiaries. It would be grossly unfair to single out and penalize non-profit organizations merely because they also own the stock of properly operating for-profit subsidiaries.

Definition of Control

A discussion option suggests that, for purposes of applying the rules for taxing investment income received from a controlled subsidiary, the test for determining control should be reduced from 80 percent to 50 percent or some other control definition. We oppose implementation of this option.

The 80 percent test was added to the Code in 1969 because the Congress reasoned that if 20 percent or more of the stock of a subsidiary were owned by outsiders, management would not enter into arrangements requiring excessive payments. There has been no suggestion that the 80 percent test has failed to accomplish the purpose for which it was enacted. We also object to the proposal that if a subsidiary is owned by several exempt organizations, then it should be treated as a controlled subsidiary of each of the exempt organizations. We do not feel this is appropriate because the ownership of stock by any multiple outside interests, whether for-profit or non-profit organizations, still would have the effect of preventing any one organization to reap more than it should on any payments from a subsidiary. Furthermore, the IRS has ample tools under present law to make certain that payments are properly structured including the reallocation of income.

Taxation of For-Profit Subsidiaries

The discussion options also provide that a controlled taxable subsidiary's income can be no less than its UBI would have been if it were still in the parent exempt organization. We object to this proposal because any for-profit organization is allowed to deduct its expenses and costs of doing business against its income and it would be unfair to single out a for-profit subsidiary of an exempt organization. To do so would be discriminating against for profit subsidiaries and furthermore, of utmost importance from an administrative standpoint, it would be extremely difficult to attempt to come up with meaningful allocations in determining what the income of the for-profit subsidiary "would have been."

Advertising Income and Allocation

Under the discussion options it is proposed that only direct costs connected with advertising may be used to offset advertising revenues. We object to this proposal because it would discriminate against non-profit corporations. All publishing companies routinely offset general costs of their publication against all revenues. To treat non-profits differently would be to go against the general principle that taxes are imposed on net income, and the proposal would violate the principles upon which our income tax laws are based.

Royalties

One of the options under consideration would apply the tax on UBI to royalties received for the use of property if the recipient created the property or performed substantial services or incurred substantial costs with respect to the development of such property. The effect of this would be to tax income from royalties earned for the licensed use of an exempt organization's name, logo or other intangible asset. We oppose this option because it unnecessarily distinguishes between types of passive income and would subject to tax a type of income which is not in competition with any taxpaying business.

By its very nature a licensing activity is not the type of business that is intended to be taxed as UBI. In fact, the kind of licensing activity typical among associations is not a business at all since it involves no commercial activity on the part of the licensor. Moreover, almost all royalty arrangements involve a taxable licensee. We do not believe that there is a proper basis for adopting this proposed option.

Allocation Rules

It is proposed that deductions cannot be made against UBI as to general overhead of the organization or for depreciation. We object to this proposal because a non-profit organization would be discriminated against in view of the fact that any other organization is able to take these types of deductions. We do not understand why a non-profit organization should be singled out and prevented from doing such in regard to any UBI.

Trade Shows

One of the "piecemeal" exclusions identified in the option proposals is section 513(d), which exempts from tax that income derived by trade associations and professional associations from the conduct of industry trade shows and conventions. Section 513(d) was enacted in 1976 to make clear that income from trade show exhibit space rentals is not UBI. Also, in 1986 the provision was extended to organizations exempt under section 501(c)(3). In both 1976 and 1980, extensive consideration was given to the issue. We do not see any reason to reverse this provision now, and we oppose such a reversal.

Nothing could be more closely related to the exempt functions of a trade association than the holding of conventions and trade shows for members of an association. Such activities permit association members and others to attend educational sessions and seminars, which education is very important to the conduct of the members' businesses. The trade show portion of a convention allows association members to be exposed in one convenient location to products useful to them in their businesses. As Congress has previously determined, the income from such activity is so closely related to the functions for which such trade organizations are exempt that it should not be taxed.

Conclusion

Mr. Chairman, it is our understanding that the Subcommittee will be holding additional hearings on the proposed discussion options. We support those additional hearings in order to facilitate a full and complete discussion of the many issues raised by these options and to assist the Subcommitttee in formulating its important recommendations to the full Committee. The U.S. League appreciates this opportunity to present its comments and criticisms on these important Oversight Subcommittee options.

Sincerely,

Coley O'Brien

UNITED STATES TESTING COMPANY, INC.
1415 PARK AVENUE, HOBOKEN, NEW JERSEY 07030
(201) 792-2400 TELEX 219504
Laboratories in Principal Cities
EST. 1880

April 7, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

We are writing with regard to the hearings and subsequent activity of the Oversight Subcommittee concerning the matter of the unrelated business income tax (UBIT) Since the Subcommittee has issued on March 31, 1988 a News Release with "discussion options" for UBIT reform, we wish to provide this comment for your further study.

To begin with United States Testing Company has been in business since 1880. We are a large, diversified laboratory with headquarters here in Hoboken, New Jersey. Since we do so many different programs and test in so many disciplines we are organizationally like twenty small laboratories all under one roof. Consequently, we compete with all types of laboratories in each field. Nonprofit competition is a serious problem for our business and we hope that the Subcommittee will recommend substantial legislative reform to correct this unfair situation.

Here are two examples of how we have been injured by the nonprofit competition issue.

We spent about two years becoming an approved laboratory for the U.S. Coast Guard to inspect and test all types of personal flotation devices. Underwriters Laboratories was for many years the sole source for this, besides the Government's own inspectors. We received approval for testing of all types of equipment, except recreational boat preservers. UL continues to be the sole source for these. The approval was meaningless and

OUR LETTERS AND REPORTS ARE FOR THE EXCLUSIVE USE OF THE CLIENT TO WHOM THEY ARE ADDRESSED, AND THEY AND THE NAME OF THE UNITED STATES TESTING COMPANY, INC. OR ITS SEALS OR INSIGNIA, ARE NOT TO BE USED UNDER ANY CIRCUMSTANCES IN ADVERTISING TO THE GENERAL PUBLIC AND MAY NOT BE USED IN ANY OTHER MANNER WITHOUT OUR PRIOR WRITTEN APPROVAL. SAMPLES NOT DESTROYED IN TESTING ARE RETAINED A MAXIMUM OF THIRTY DAYS.

MEMBER OF THE SGS GROUP (SOCIÉTÉ GÉNÉRALE DE SURVEILLANCE)

we never obtained one client, because no manufacturer of these preservers wanted to have two inspection organizations, and since they had to have UL for the one type, they stayed with UL for all.

Secondly, the Testing Company has a branch identified as the Crane Inspection and Certification Bureau in Orlando, Florida. This group is a leader in crane inspection, testing, and training of operators. However offshore cranes are regulated by the Coast Guard. We have been trying for several years to receive approval and have been told that only a nonprofit inspection agency is eligible to perform this. The American Shipping Bureau is one of two approved nonprofits.

Both of the above examples are only a few instances showing that U.S. Testing performs important work related to public safety. We pay taxes on our profits. All testing and inspection firms should do likewise. The "discussion option" to "Modify rules applicable to organizations' testing for the public safety'" is weak and unacceptable. The exemption for "testing for the public safety" should be deleted.

Thank you for the opportunity to present these views. We are truly concerned with this unresolved problem and look forward to a real solution.

Very truly yours,

UNITED STATES TESTING COMPANY, INC.

Allen F. Maxfield

Allen F. Maxfield
Vice President

AFM/lh

cc: ACIL Office
Congressman Frank J. Guarini

STATEMENT

OF

UNITED WAY OF AMERICA

GOVERNMENT RELATIONS TASK FORCE ON FOR-PROFIT/ NONPROFIT COMPETITION

I. Relatedness Test

United Way of America supports continuation of the test of relatedness to the charitable purpose as the best method of distinguishing between commercial and charitable activities. It is still the most appropriate test for determining tax exemption.

United Way of America recently conducted a sample survey of the voluntary human service agencies that United Ways fund, and their income generating activities -- both related and unrelated. We undertook this survey in conjunction with several national voluntary agencies in the Grants and Contracts Project to examine whether most voluntary human service agencies were conducting their activities in a manner that is commercial and unfairly competitive with business. We found that this is not the case. A summary of the survey results is attached.

Voluntary human service agencies are engaged in very little UBI activity. Where they do charge fees for service, these are based on ability to pay. Those people served in this manner are primarily at low and moderate income levels. Those who pay the market rates for service are proportionately small and at the higher levels. However, this income is needed to subsidize service to others because charitable contributions are not sufficient to do the job and subsidy payments by third parties (insurance or government programs), where they exist, are usually not sufficient to cover the shortfall.

Many, if not most, services which traditional charities provide also have a commercial counterpart. Family counseling, child care, crisis counseling (rape, suicide prevention, etc.) outpatient care, home health care, and health screening, are just a few examples. What distinguishes charitable from commercial activities is not that one activity is always "inherently charitable" and another "inherently commercial." If this were the case all soup kitchens and food pantries for the poor should be taxed if they charge a token fee for what is more "inherently commerical" than restaurants and grocery stores?

What distinguishes charitable and commerical activities is how, why, and to whom the services are provided. Charities provide services for a fee but do so to provide either a type of service unavailable on the commercial market or at a price that enables a broad range of the community to have access to a critical service which our society wants people to benefit from. Would we want to keep the deaf from hearing simply because they couldn't pay the full cost of an adequate hearing aid? Would we want young children to be home unsupervised and risk death or injury from an accident simply because their mothers can't afford to pay the full cost of child care? Yet commercial firms do provide these services at market rates.

If we replace the relatedness test with a commerciality test, we could label all nonprofit activities as "inherently commercial" because they could all be done in a commercial manner. This would undermine and devalue our concept of voluntarism which has enriched our society for over 200 years. We developed public policies such as tax exemption to support these activities. We need to continue to recognize and support the contributions that voluntary human services make to society if these efforts are to be sustained.

This support is especially critical in an era when everyone is so painfully aware of both the limitations on government resources and power and the proliferation of complex human problems. The development of a welfare underclass; teen crises such as parenthood, suicide, and drug and alcohol abuse; an alarming rate of adult illiteracy and other problems pose enormous challenges to our society to overcome. Government can't do it alone. The voluntary sector has been asked to do more and to work increasingly in partnerships with government to meet these needs.

We in the United Way network have taken on this challenge by pledging to double our financial, and volunteer resources in the next five years. But we can't do the job if the federal government decides to tax fees for services which are used to extend services to more people than possible with charitable contributions alone. We can't do the job if the federal government decides to tax charitable contributions and charitable fund raising efforts. We can't do the job if the federal government decides to tax investment income from charitable contributions.

The subcommittee's proposals would label as commercial some activities which we believe do fulfill a charitable purpose. This action may not result in a tax bill for many agencies. In most cases the agencies involved would probably not have to pay taxes because the charges for these activities are below the market rates and do not cover the cost of the service. The fees would not produce a surplus that could be taxed. However, the labelling problem could still put these activities in jeopardy. Agencies could lose their exempt status, if such "non-exempt" activities were found to be the agencies' primary purpose. The tax code requires a nonprofit organization to have an exempt purpose as its primary purpose.

We agree that the activities the subcommittee has identifed as "inherently commercial" have posed problems and that exemptions should be withdrawn from some activites within them. But we do not support the broad brush approach of labelling all activities in these categories as commercial. We believe these activities require closer scrutiny in applying the relatedness test. The relatedness test could address all these problem areas if regulations or guidelines were developed along some of the lines suggested by the subcommittee without labelling these activities "inherently commercial." Enacting these provisions into law would further complicate the tax code, making both compliance and enforcement more difficult. With proper guidelines and vigorous enforcement, the substantially related test can accomplish the subcommittee's goals.

However, if the code is changed or regulations or guidelines developed on the activities the subcommittee has identified, many important human service activities can be protected by combining the substantially related test with the access test the subcommittee recommends for health and fitness. This standard guarantees critical services to people in need through broad based availability and subsidies. It holds the voluntary human service community to a higher standard than other segments of the nonprofit sector such as education and the arts which do not widely offer services based on ability to pay. Nevertheless, the human service sector is dedicated to this principle and is willing to hold itself bound by it as a criteria for tax exemption.

The proposed substitution of a "directly related" test for the present "substantially related" test would not achieve the subcommittee's goals. First, the subcommittee has not defined this term, making it difficult to assess the impact of this change. On its face, it doesn't seem much different than the present test. However, as a new term, it would have the disadvantage of having no history of interpretation by the IRS or the courts. As a result, this amendment would likely create greater ambiguities and confusion than the present test which has 38 years of interpretation behind it. Here, once again, present law would be improved by further definition and interpretation of the substantially related test. But this is best done through regulations or guidelines, not in the statute. The present IRS Tax Exempt Advisory Group is already examining UBIT compliance issues in addition to lobbying rules. This group could be expanded to develop guidelines for applying the substantially related test to the areas which the subcommittee identified as troublesome.

Recommendations.

1. Retain the present substantially related test for tax exemption of all income-generating activities. Do not establish categories of "inherently commercial" activities.

2. Direct the IRS to develop regulations or guidelines according to the subcommittee's discussion options to better define the

application of the relatedness test generally and to address areas which have generated frequent complaints.

3. If changes in the code are made or if regulations or guidelines are developed, preserve exemption for activities which are substantially related to an organization's exempt purpose where the organization makes the goods or services available to a reasonable cross section of the general public, such as by scholarship or by fees based on community affordability.

I-A. Gift Shops - Catalog Sales

We agree that off-premise sales of items available commercially can be a problem. However, this proposal as written would tax activities of human service organizations that are closely tied to their programs, their charitable missions, and participation in their activities. Following are examples:

- United Way of America's sells items used in local charitable fund raising campaigns, for staff and volunteer training and volunteer recognition. These range from publications such as how-to manuals, reports, films, and videos for educational purposes to awards, pens, and tee shirts with the United Way logo affixed. Most educational materials are produced by staff or paid consultants. Other items are commissioned from for-profit manufacturers. United Way of America sells these items to its local affiliates, voluntary and public agencies and to corporations which run United Way campaigns.
- Camp Fire and Girl and Boy Scouts sell uniforms and merit badges which are integral to participation in their programs.
- YMCA and YWCA sells shampoo, deodorant etc. for "emergencies" of residents or swimming pool users who have forgotten to bring their own supplies or who have run out of them unexpectely.
- Goodwill, Salvation Army, and other agencies providing vocational or rehabilitation services produce commercial products and services to give on the job training and experience to their clients. These sales are an integral part of the training. Without it the clients would not gain experience in a real work environment.
- Nursing homes and other chronic care facilities sometimes have gift shops for visitors. Gifts to these patients boost their morale and well being as much as gifts to hospital patients.

Recommendations

1. Retain the substantially related test for this item.
2. If the substantially related test is not maintained, or if regulations or guidelines are developed for this activity:
    a. Exempt on-premise sales of low cost items (subject to a dollar cap) related to an organization's program.
    b. Extend the hospital gift shop exceptions to nursing homes and other chronic care facilities.
    c. Preserve the exemption for off-premise sales for items sold to members, affiliates, and program participants, and which are substantially related to the organization's exempt purpose.
    d. Preserve the exemption for income from the sale of goods produced in the course of vocational training or rehabilitation programs in so far as the programs are operated only to the extent necessary to further the orgaization's exempt purpose.

I-B. Medical Equipment and Devices

United Way of America supports limitations on exemption for such activities if aimed primarily at people who do have adequate access through the commercial market. Lack of geographic availability, however, is only one measure of access and availability should not be too strictly determined. One outlet miles away on the other side of town may not be adequate for an elderly person whose frail health would make this an arduous trip, or someone who lacks transportation. And what if the item in question is too large or heavy to carry on mass transportation and the commercial outlet does not deliver such items?

Another, equally important, measure of availability is financial resources. Many people are not poor enough to qualify for medicaid, yet not able to afford market rates for medical equipment, drugs, and tests. Nonprofit agencies often provide subsidies for such sales and rentals. Would you deny these people access to wheel chairs, hospital type beds, high blood pressure medicine and other such items because they can't offer the market prices?

Recommendations

1. Retain the substantially related test for this item.

2. If the substantially related test is not retained, or if regulations or guidelines are developed, preserve exemption for activities which are substantially related to an organization's exempt purpose where the organization makes the goods or services available to a reasonable cross section of the general public, such as by scholarship or by fees based on community affordability.

I-C. Health, Fitness, Exercise.

We support this approach to these services because it reinforces the voluntary human service sector's commitment to access to services.

Recommendations

1. Retain the substantially related test for this item,

2. If the substantially related test is not retained or if regulations or guidelines are developed, adopt this option.

I-D. Travel and Tours

We agree generally that this is an area with some questionable activities. However, we are concerned about two points:

1. The definition of travel should not be broad enough to eliminate exemption for transporting people within localities to human services and programs. Such transportation helps the handicapped, elderly, children, and the economically disadvantaged get to services they badly need. This can be a key form of outreach to ensure that people get badly needed services. Often, these people are not able to afford the cost of private transportation, cannot utilize public transportation easily because of their conditions, or, as in rural areas, transportation is not otherwise available. In many cases, providing the transportation helps families overcome obstacles to obtaining the service. Working parents, for example, do not have to leave work to take children or handicapped family members to services such as child care, physical therapy, or counseling .

2. The scope of this proposal should not include travel or tours for those who otherwise would not have access to them such as the elderly, youth, the disabled, or disadvantaged. For example, agencies serving the elderly rent a bus and take them to a nearby city or the country for a day or an overnight trip. These trips are not luxury class, but they boost elderly people's morale and contribute tangibly to their health and well being. Participants are typically people who either can't afford to take a commercial

tour or who need more specialized care and attention because of their frailties than commercial tours can offer.

Recommendations

1. Retain the substantially related test for this item.

2. If the substantially related test is not retained or, if regulations or guidelines are developed on this item:

   a. Preserve exemption for local transportation services provided to ensure access to exempt services that would otherwise be unavailable or provided as an integral part of an exempt service such as outreach.

   b. Preserve exemption for travel and tours which are for activities which are substantially related to an organization's exempt purpose where the organization makes the goods or services available to a reasonable cross section of the general public, such as by scholarship or by fees based on community affordability.

I-E. Adjunct Food Sales

We support the basic premise, and support the subcommittee's desire not to apply UBIT to provision of food to the poor, the homebound and the elderly. We are concerned that the language of this proposal be carefully crafted so as to avoid this result. If such services are a small part of a larger program unrelated to the food service, they could be construed as adjunct and become taxable. For example, a senior center which delivers a small number of meals to the homebound elderly for a token charge could be considered taxable if this service were deemed to be adjunct. Similarly, a homeless shelter which sends a mobile van out to feed street people for a small charge could be subject to taxes. Both these services are important forms of outreach to people who would neglect to take care of themselves properly without this aid. Here also, food services and sales done as a part of vocational training or rehabilitation programs should not be taxed.

Once again, the substantially related test should be sufficient to limit most adjunct sales while preserving these exceptions if applied rigorously.

Recommendations

1. Retain the substantially related test.

2. If the substantially related test is not retained or if regulations or guidelines are developed,

   a. Preserve exemption for activities which are substantially related to an organization's exempt purpose where the organization makes the goods or services available to a reasonable cross section of the general public, such as by scholarship or by fees based on community affordability.

   b. Preserve exemption for adjunct food sales done in the course of vocational or rehabilitations programs in so far as the programs are operated only to the extent necessary to further the exempt purpose.

I-F. Veterinary Services

Here, too the substantially related test should be able to address these problems if applied rigorously.

I-G. Hotel Facilities

The subcommittee's exemption for operations limited to fulfilling an exempt purpose indicates that the substantially related test could suffice to narrow the exemption for current practices if applied rigorously.

We are concerned that the language be crafted carefully so as not to affect shelters for the homeless, group homes for mentally or physically disabled, or single room occupancy residences such as those operated by the YMCA and YWCA for people needing low cost transient housing in a safe and secure place or those operated by other nonprofit groups to provide shelter to homeless people as an alternative to group shelters.

Recommendations

1. Retain the substantially related test.
2. If the substantially related test is not retained, or if regulations or guidelines are developed, preserve exemption for activities which are substantially related to an organization's exempt purpose where the organization makes the goods or services available to a reasonable cross section of the general public, such as by scholarship or by fees based on community affordability.

I-H. Routine Testing

We support limitations on exemption for some laboratory testing. Although we understand the subcomittee is primary concerned with laboratory testing, we believe the term "routine testing" is misleading and needs clarification. Nonprofit human service agencies provide many kinds of routine testing as a part of a larger service program as well as standing alone. These include health screening for blood pressure, AIDS, diabetes, and other conditions to provide widespread access to disease prevention and early diagnosis of illness. Other tests include diagnostic testing for mental health, vocational aptitudes, or physical fitness. It is unclear whether these types of tests would lose their exemption. They are sometimes provided for a small fee to help defray costs. The substantially related test should be able to narrow exemptions in this category without harming the activities that concern us. This standard has simply not been applied rigorously enough.

Recommendations

1. Retain the substantially related test.
2. If the substantially related test is not retained or regulations or guidelines are developed, preserve exemption for activities which are substantially related to an organization's exempt purpose where the organization makes the goods or services available to a reasonable cross section of the general public, such as by scholarship or by fees based on community affordability.

I-I. Affinity Credit Cards/Catalog Endorsements

Affinity credit cards represent passive income where the credit card company simply issues the card using the exempt organization's name and logo. Where this is the case, we believe it is unfair to tax this activity while retaining exemption for all other forms of passive income. It is appropriate to exempt passive income because it does not represent a nonprofit activity which competes with for-profit activities. The credit card companies are continuing to profit from these activities. The affinity cards are typically appealing to members and affiliates of an exempt organization as a means of supporting its charitable activities and making others aware of them.

Recommendations

Retain tax exemption of all genuinely passive income.

I-J. Advertising Income

We do not object to taxation of advertising income. However, we believe it is unfair to treat tax exempt organizations differently than for-profit organizations by forbidding deductions for other than direct costs.

I-K. Theme/Amusement Parks

We do not object to the subcommittee's selection of this activity as a questionable one. However, we do believe a strict application of the current substantially related test would curb these activities.

Recommendations

Retain the substantially related test for these activities but require a heavy burden of proof on this question.

I.L. Additional "Inherently Commercial" Activities

This item illustrates the reason why targeting specific activities is not an appropriate way to address concerns about UBIT. It opens the door to a myriad of specific exceptions in the law. This approach has the potential to label truly charitable activities as "inherently commercial" and to possibly chill those activities. It can create a crazy quilt of special interest provisions in the UBIT law in response to whoever complains the loudest and without regard to a careful analysis of the questioned activities. It can add greatly to the confusion which many small, tax exempt human service organizations have concerning compliance. How many additional activities will be so labelled this year, next year five years from now? This approach sets a bad precedent for the unfair treatment of truly charitable activities.

Recommendations

Retain the substantially related test and enforce it vigorously.

II. Convenience Exception

We support this approach. Strict application of the substantially related test is the most appropriate way to narrow exemptions for questionable activities.

III. Activities Not Regularly Carried On

We support the taxation of trade or business activities which are regularly carried on and believe that the definition of what constitutes "regularly carried on" should be tightened and clarified. However, occasional fund raising activities should not be taxed. An activity which is not often carried on does not constitute a competitive threat to for-profit activities which are conducted frequently.

While the subcommittee expresses its belief that, benefit galas are not trade or business activities, we are not so sanguine that they will, in all cases, be interpreted so by the IRS or the courts. With regard to these benefits this provision would constitute a tax on charitable contributions. Whenever an organization holds a charity auction, a benefit night at the theater, a reception, or a dinner, the proceeds could be taxable. The tax would cover not only the portion of the ticket deemed to be the fair market value of the event, but also the portion deemed to be a charitable contribution and therefore deductible to the attendees.

Although the current exemption for trade or business activities conducted substantially by volunteers would be preserved, it might not apply to most of the above listed activities. These activities are planned by a committee of volunteers, but most implementation is done by paid staff of the nonprofit organization sponsoring the event or of the for-profit enterprises engaged to carry them out (i.e., theater production company, hotel or restaurant personnel, or auctioneers).

In an era when public officials are regularly exhorting nonprofit organizations to do more to help people and address community problems and expand the pool of financial and human resources necessary to do the job, it is counter-productive for the federal government to make this task more difficult by taxing the proceeds of charitable fund raising events and the charitable contributions made in connection with them.

Recommendations

1. Retain the "not regularly carried on" exemption.
2. Define what constitutes regularly carried on in various types of activities through regulations or guidelines.

IV. Royalty Income

We recognize the need to limit exemption for those activities which do not represent genuinely passive income. We do have concerns that the subcommittee's approach erodes the principle of exemption for passive income and will inadvertently tax income from charitable sales promotions and other activities which are substantially related to a charitable purpose.

The measure by which royalty income is paid (based on net or taxable income) is not a good test for distinguishing when royalty income is something more than passive income. Using this test will erode the principle of exempting passive income and could open the door to the taxation of other forms of passive income. The subcommittee should instead rely on tests which truly measure the level of activity and involvement in producing a product.

In addition, other royalty activities that may not be genuinely passive may be regulated by applying the substantially related test instead of eliminating exemption for all.

Charitable sales promotions could be interpreted as royalty activities. In a charitable sales promotion a for-profit company advertises to the public its support for the activities of a nonprofit organization and offers to make a contribution to the charity when its product is purchased or used. The charity benefits from not only the charitable contribution but also the publicity that the company's endorsement brings. This, in turn, helps boost public contributions to the charity.

We are concerned that the contribution to the charity might be construed as a royalty for the use of the charity's name. Some payments under charitable sales promotions are based also on net or taxable income. In addition the charity's giving permission for the use of its name could be construed as performing a service in the marketing of the product. In a charitable sales promotion the charity has nothing to do with the creation of the product. The company simple advertises its support for the charity when marketing the product.

While United Way of America does not engage in charitable sales promotions, we know that these have been a positive vehicle for expanding financial resources for charities and for increasing public awareness of the important role that charities play in our culture. This practice has helped many agencies overcome the loss of resources from federal funding cuts in their service programs.

Recommendations

1. Preserve the exemption for genuinely passive royalty income by not taxing such income merely because it is measured by net or taxable income.
2. Apply the substantially related test not a "directly related" test to royalty income determined to be acquired through active involvement.
3. Preserve exemption for income from charitable sales promotions.

V. Exempt Amount Of UBI

We support raising the current deduction for UBIT to $10,000. The staffing and related costs of filing a return, paying the tax, and submitting to audit would justify a higher ceiling than the proposed $5,000. The higher amount would also more appropriately reflect the inflation of the past 38 years. This exemption should also continue to exempt those organizations who qualify from filing the 990-T form.

Recommendations

1. Raise the current exemption from UBIT to $10,000.
2. Exempt organizations from filing form 990-T if they earn $10,000 or below in UBIT.

VI. Debt Financed Income.

As this provision does not apply to voluntary human service organizations, we have no comment on this change.

VII. Subsidiaries and Joint Ventures

We have no comment on this change.

VIII. Allocation Rules

Exempt organizations should be permitted to deduct from income derived from nonexempt uses of a facility that proportion of depreciation and overhead which accurately reflects the extent of nonexempt use. It is unfair to treat nonprofit organizations in a different manner than for-profit organizations with regard to for-profit activities.

Recommendations

Retain equitable allocation rules between for-profit and nonprofit organizations for deductions from nonexempt income.

IX. Reporting

We wholeheartedly support increased reporting on 990 and 990T. We also support increased identification and enforcement of noncompliance. We believe that many problems in UBIT can be addressed by more vigorous action to apply the current law strictly. We also believe that studying any provisions enacted after five years will give us all a better understanding of how UBIT is working.

However, we are concerned that 990-T not be expanded to the point that organizations with no UBI would have to file both 990 and 990-T. This would impose an unnecessary paperwork burden on smaller organizations. It would be simpler to expand the 990 more fully to obtain additional information on UBIT and other revenue sources.

We also support the development of a shorter reporting form for small organizations and waiver of the 990-T filing requirement for charitable organizations earning exempt levels of UBI. ($10,000 or below is proposed) Our survey of human service agencies' revenue raising activities also indicated that small organization rarely undertake UBI activities or establish for-profit subsidiaries so there would be little likelihood that taxable income would be overlooked.

In addition, we are pleased that the subcommittee will consider a study of joint ventures before enacting amendments. Our primary concern in this area is with the role they play in the financing, construction and renovation of low income housing. In light of the shortage in low income housing, the cuts in federal housing funds and the increase in homeless families, we must encourage rather than discourage incentives for such public/private/voluntary partnerships.

Recommendations

1. Rely on an expanded 990 form for information on revenue raising activities, rather than 990-T.
2. Continue to permit organizations not earning UBI or earning only exempt amounts of UBI to forego filing form 990-T.
3. Develop a short 990 form for smaller organizations.

X. Miscellaneous Provisions

We have no comments on these items.

Concluding Comments

We are pleased to have the opportunity to comment on the subcommittee's discussion options. This is a complex area of the law in which small nuances can impair the ability of charities to provide services which are very important to the lives of the people they help. These nuances can also erode our dynamic tradition of voluntarism which has contributed greatly to the quality of life and opportunity available in this nation for over the 200 years.

For this reason, we feel it is important to have further opportunities to comment on the subcommittee's proposals as they take shape, and especially on any legislative language the subcommittee drafts.

United Way of America

Survey on For-Profit/Nonprofit Competition in the Human Service Sector

Some business people, particularly in small business, are complaining that nonprofit organizations have greatly increased their involvement in activities which they consider to be commercial. They have claimed that nonprofit organizations are often offering the same products or services as they. Because nonprofits are tax exempt, these business people believe their costs are lower and they can compete unfairly with business.

In June of 1987, the House Ways and Means Committee's Oversight Subcommittee held extensive hearings on the Unrelated Business Income Tax (UBIT). This tax is imposed on the income from exempt organizations' trade or business activities which are not related to their charitable purposes and which are not regularly carried on. United Way of America testified at these hearings on behalf of the voluntary human service organizations it serves.

At these hearings the Subcommittee Chairman, Representative J.J. Pickle requested more data on the revenue raising activities of tax-exempt organizations from the witnesses. In response, United Way of America created a sample data base to yield a national perspective on both related and unrelated business income activities in the voluntary human services sector.

United Way of America is the national service and training center for over 2,300 United Ways across the country. Each United Way is a separately incorporated, tax exempt organization under section 501(c)(3) of the IRS code. Approximately 1,400 of these United Ways are dues-paying members of United Way of America. United Ways distribute funds to approximately 37,000 separate tax-exempt human service agencies which are also independent tax-exempt organizations.

United Way of America does not control its United Way affiliates. Neither do United Ways control the agencies they fund. In order to collect data from United Ways or their funded agencies we must ask for voluntary cooperation.

United Way of America developed this survey in conjunction with national voluntary human service organizations participating in the Grants and Contracts Project. A roster is attached. To distribute the survey United Way of America's Research Department, selected a sample base of 89 communities balanced according to size and regional representativeness. United Ways in these communities were asked to survey a designated sample number of the agencies they fund. These United Ways were instructed to balance their selections in terms of size as well as the likelihood or unlikelihood that businesses might consider some of their activities to be competitive. In all, United Ways distributed surveys to 1,000 agencies. The results are based on a response rate of 35.7%, a rate which is considered statistically valid.

Following are the results of this survey:

UBI ACTIVITY

Did your organization file a Form 990-T (for reporting unrelated business income) with the Internal Revenue Service (IRS) in the past year?

7% YES **93% NO**

Of those that did file a Form 990-T, the average gross UBI as a percent of total agency revenue was only 3%.

In the past five years, has an Internal Revenue Service audit of your organization ever challenged the tax status of any income-producing activities other than those activities reported?

1% YES **99%** NO

Of those agencies answering "yes," 75% said the IRS found that activity to be related to the organization's charitable purpose and therefore, not taxable. The remaining 25% said the activity was ruled to be unrelated to the organization's charitable purpose, but not taxable because the activity was exempt under some other provision of the law. Therefore, IRS audits have uncovered no taxable income-producing activity. These findings suggest that human service agencies are not failing to report taxable income.

> **Given the definition of "unrelated business income" provided, are there any activities currently being conducted by your organization which you believe may be subject to taxation and have not previously been reported as unrelated business income?**

4% YES **96%** NO

One function of this survey was to educate nonprofit human service agencies on UBIT and its requirements. As a result, some agencies felt they may unknowing have been out of compliance with the law. This was a small percentage of respondents. Charging fees for service, selling a product or service, and renting facilities or equipment were the most common activities which agencies thought might be UBI.

> **Has your organization established a for-profit subsidiary?**

3% YES **97%** NO

This once again illustrates that nonprofit human service agencies are not entering into a high level of commercial activities.

COMPLAINTS OF "UNFAIR" COMPETITION

> **Has you organization received complaints alleging "unfair" competition?**

7% YES **93%** NO

The small number of actual complaints received implies that most for-profit and nonprofit organizations co-exist compatibly in the human services portion of the sectors. Human service activities are not a major focal point of small business concerns.

GROWTH IN REVENUE RAISING ACTIVITIES

> **In the past five years, has your organization instituted or significantly increased any activities in order to raise revenues?**

Thirty percent of all respondents said they had begun charging fees for service to raise revenues, while 35% said they were providing more services with government funding (i.e. grants, purchase of service contracts, employee assistance programs.) On the other hand, 17% of agencies surveyed considered initiating revenue-producing activities but rejected the idea because they might be taxable as unrelated business income. This figure shows that although the need for additional income is pressing, some nonprofit human service agencies are themselves reluctant to plunge into many revenue producing activities. These data contradict many of thesuggestions that many nonprofits are heavily increasing involvement in these activities.

The agencies pursued these activities in order to meet new or increased needs for services in 67% of cases, and replace lost government funding in 33% of the responses. Since 1981, cuts in government funding have led nonprofit agencies to become more self-sufficient by seeking alternative sources of funding.

NATURE OF REVENUE - PRODUCING ACTIVITIES

Does your organization provide products and/or services on a fee arrangement?

65% YES 35% NO

In those cases where a fee arrangement is used, these fees provide 30% of total agency budget. It is important to note that 85% of organizations charging fees do so at less that full cost based on ability to pay, and 36% of all products/services offered are provided at no cost.

Of the products/services provided at less than full cost, 32% do not involve subsidies from other sources such as insurance, United Ways, or a government program. This reveals that while these sources of funds are valuable ways of subsidizing service to those unable to pay their full cost, they are not enough to pay for the services needed. Agencies need to use the surplus raised from full-paying clients to help pay for services to those paying only a portion of the cost of the service, or nothing at all

Does your organization provide products/services for which the cost is reimbursed in whole or in part by a third party?

58% YES 42% NO

Even when a nonprofit agency receives a third-party payment which subsidizes service to some clients, these payments, typically, do not cover the full cost of service. Additional subsidies are needed through full paying clients. Of the 58% of the agencies receiving third-party reimbursement, only 31% of products/services are reimbursed at full cost. In 43% of the services the reimbursement rate is too low to cover the cost of providing the service. Agencies look to income from those clients who pay the full market rates to help them subsidize services to those who can pay only a portion of the cost of the service.

Services provided for a fee are also overwhelmingly targeted to low and moderate income households. They do not generally benefit people who can afford to pay market rates. On average, 42% of individuals receiving products/services at less than full cost have an annual household income less than $7,000, 33% between $7,001-14,000 and 23% between $14,001-28,000.

Does your organization regularly sell products (e.g. medical devices, food) to the general public?

12% YES 88% NO

Sales of products are not generally based on ability to pay. Of those agencies selling products, most do not link their cost (76%) or eligibility to purchase (81%) to ability to pay. This may indicate a problem in product sales. On the other hand, these sales may represent an activity related to the agencies' charitable missions or a fund raising activity which is exempt as being "not regularly carried on.

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April 14, 1988

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Chairman Pickle & Members of the Subcommittee,

The United Way of Illinois is pleased to have the opportunity to comment on the subcommittee's discussion options concerning proposals on the Unrelated Business Income Tax (UBIT). This is a complex area of law in which small nuances can impair the ability of charities to provide services which are very important to the lives of people they help and the community in general. They can also erode our distinct American tradition of voluntarism which has contributed greatly to the quality of life and opportunity available in this country over the past 200 years.

The United Way of Illinois is a statewide organization representing over 300 local community fundraising organizations, known as United Ways, United Funds, United Givers and/or Community chests; which review and determine local needs and provide support to over 1,200 charitable health and human service providers in the State of Illinois. United Way supported agencies provide social services to at least one out of every three citizens in the state. The range of services supported by local United Ways run from prenatal care to care and services for the frail elderly; literally serving Illinois citizens "from the cradle to the twilight of their lives."

Many of the services provided by these agencies are also supported and funded by state and federal government as well as thru their own fundraising efforts. The utilization of volunteers to provide management, direction, fundraising and services greatly reduces overhead and fundraising expenditures on the part of these charitable groups and reduces the cost of social service delivery whichwould otherwise fall to the state and federal government and American taxpayer. Increased need and demand for services delivered by United Way agencies and the struggle to raise more funds to meet these needs, in a time of increased competition for charitable dollars, has led some of our agencies to seek new and innovative ways for raising much needed funds in order to continue to meet the expanding needs in our communities.

Charitable human service agencies have responded to the cries of corporate and business donors and government to be more "businesslike" and seek other means to raise needed dollars. It is some of the Charitable Communities response to business and government itself which has at this point brought your Committee to examine the issues concerning Unrelated Business Income Tax (UBIT). We understand and agree with the Subcommittee's identification of specific problem areas and we agree that some changes in the law may be needed to address certain trouble areas.

Under proposals offered by the Subcommittee one could say that everything could be considered commercial and some of the proposals offered are a way of responding to special interests. Basically, nothing is "inherently" charitable or commercial and the current Relatedness Test in existing law is the best way for determining the appropriate nature of charitable activities. The United Way of Illinois recommends and supports continued reliance on the relatedness test as the best method of distinguishing between commercial and charitable activities.

There are some activities occuring under the areas you have labeled as "inherently commercial" which are in fact charitable; not because of their inherent nature but because of how and why they are done. The labeling of some of those areas as "inherently" commercial does not reflect an understanding of charitable fundraising, administration or motivation. Moreover, many of the Committee's proposed discussion options could have damaging repercussions on the human service delivery system, the business community and the overall quality of life in this country by ultimately taxing charitable contributions which many of these suggested proposals could do.

We are also concerned that in some instances, a higher standard is set on charities than on other groups such as education and proprietary businesses. This attitude is most disturbing as the United Ways and the charitable groups we fund meet such critical human needs.

Attached you will find United Way of Illinois' responses to various proposals offered by the Subcommittee and in some instances examples of their impact.

Sincerely,

Rebecca W. Owens

Rebecca Owens, Director
Government Relations, Springfield Office

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RESPONSE TO HOUSE WAYS AND MEANS COMMITTEE OVERSIGHT SUBCOMMITTEE DISCUSSION OPTIONS ON UBIT.

Certain specific issues and options you have proposed and examples are discussed below.

I. Substantially Related test

United Way of Illinois recommends and supports continued reliance on the relatedness test as discussed in our cover letter.

I A. Gift shop/bookstore income

The Committee's option statement does not indicate if exemptions similar to those afforded hospitals and universities would be afforded to other types of charitable institutions that also have a "community" of on-premises employees and people served, such as sheltered workshops for the developmentally disabled, senior centers, nursing homes and other community service groups.

Catalog and other mail or phone order sales

As we understand your option statement all off-premises catalog and mail or phone order sales would be subject to tax even if the materials were educational or otherwise supported exempt purposes. To local United Ways, this would mean that materials local United Ways purchase thru the United Way of America for assistance in fundraising and education and community problem solving etc. would be taxed, thus increasing certain fundraising and operation costs and further reducing the portion of a donors gift which is allocated directly to local charities aimed at improving the quality of life in a community. Currently local United Ways in Illinois allocate an average of 90 cents of every donated dollar for provision of direct services, this is one of the most cost-effective ways of donating charitable dollars which address a significant number of local human service needs.

Many of our recipient groups would also be adversely affected in their fundraising efforts thru this provision such as taxing sales of Girl Scout cookies for example or sales of other items for fundraising events which are held off premises. This could have the effect of limiting the number of people served by reducing proceeds from fundraising. The overall human effect of potential reduced services is unknown but we can only speculate that in all likelihood it would diminish the quality of life in the community and in some circumstances put further strains on local and state governments.

United Way of Illinois recommends exemption of purchases relating to participation in an organization's program and sales of continuance of the "relatedness" provision for fundraising supporting the exempt program be adopted.

I B. Medical equipment, laboratory testing and pharmaceuticals

Some limitations in this area may be appropriate but limitation to access based only on a geographic area alone is an insufficient measure as one very important factor affecting access is financial resources. Many of the working poor or others on limited fixed incomes may not qualify for Medicaid but can't afford certain needed medical equipment, drugs or tests.

Some United Way funded services include such things as free or low cost (based on a sliding scale) hearing and vision screening for children and adults, testing for lead poisoning in children and many more, as well as provision for low rent or purchase (based on ability to pay) of needed medical equipment.

The United Way of Illinois suggests that exemption should also be given for goods provided based on ability to pay with access assured to people who cannot otherwise afford to pay for them.

I D.Travel Services

Our main concern on this option proposal relates to how travel would be defined. It should not be so broad as to eliminate exemption for transporting people to human services and programs. Such transportation helps the handicapped, elderly, children get to programs and services they need. This is especially true for those persons living in rural areas of Illinois and handicapped individuals who cannot be accommodated by accessible, if any, public transportation system. Transport of handicapped individuals to work keeps them productive members of the community and transport of children, disabled individuals or the elderly to day care, medical or counseling services which are needed allows working parents and/or caretaker relatives to maintain their employment and not potentially jeopardize their livelihood.

Additionally, this proposal should not include travel or tours for those who otherwise would not have access to them. For example, a community service groups that rents a bus or van to take poor inner-city children or youth to a farm or hiking for the day.

United Way of Illinois recommends there be an exemption for transportation related to participation in a community program or service and travel and tours which provide access to people who otherwise would not be able to participate in such activities.

I E.Subcommitte Option regarding application of UBIT to adjunct food sales unless on-premises or provided primarily for students, faculty, employees, members or visitors option proposal.

United Way of Illinois is concerned that this proposal could be applied to the provision of food to the elderly, shut-ins or the homeless. If such services are a small part of a larger program unrelated to the food service, they could be construed as adjunct and become taxable. In 1987 in Illinois 8,086,891 meals were provided to 144,586 senior citizens alone thru the Meals on Wheels program. Through local charitable service organizations. Delivery of meals to thousands of elderly citizens who are unable to adequately prepare and provide meals for themselves is done by volunteers and recipients are often asked to provide a small fee, based on their income, for preparation and transport. This service could be considered taxable if it was deemed to be adjunct.

Additionally, in many local communities churches and other local non-religious charitable groups will set up soup kitchens or food pantries to help feed and/or supplement diets of poor people in the community who might be further malnourished or become ill without certain food supplements. If this service is adjunct to the overall determined purpose of the charitable group and considered taxable, many could possibly discontinue these beneficial services for fear of jeopardizing there overall exempt status.

Many of these proposals are inconsistent with other government programs which encourage these activities by charitable groups. For instance, regional food pantries which receive federal surplus food commodities would potentially lack local distribution points for fulfilling the purpose of providing food supplementation to those in need. Also there are some further contradictions to other governmental programs and how they would be viewed such as providers of Women Infants and Children (WIC) food supplements to pregnant and breast feeding mothers who are low income. Most of these distributions are done through local charitable social service agencies in which the WIC supplemental feeding program may be one of several provided. Additionally, recently the U.S.D.A. issued rules that would allow not-for-profits who have congregate feeding sites such as homeless shelters, domestic violence shelters and residential drug treatment centers that provide meals may accept food stamps for payment toward provision of food. The Committee's proposal concerning this area seem to be inconsistent with other branches of the federal government which are encouraging and supporting the private charitable sector through these types of enhancements to set up and continue these types of services.

This particular section presents problems for many charities engaged in fundraising to support their programs. For example: in the city of Springfield, Illinois, a city festival is held each July 4th weekend. The city government encourages Local not-for-profit groups to participate by setting up food and beverage tents for those attending. By doing so the city feels it can assist those groups with their fundraising efforts, make the public more aware of the services and groups in the community and promote the community as a whole. Not-for-profits which participate utilize volunteers to prepare and sell various food and beverage items. The items are paid for with tickets purchased at various locations in the area. Local businesses receive benefits thru purchase, by the nonprofits, of their various products for sale after preparation. Local businesses also participate and do not have to collect tickets for their sales at the festival. This provides a "win/win" situation for all sectors in the community by promoting visitors to the community, providing local businesses with exposure and assisting community services in supporting their programs which enhance the quality of life.

The subcommittee can avoid this interpretation by exempting sales which provide access or outreach to people who might not otherwise be able to meet these needs themselves.

I H. Regarding the Subcommittee's proposal of applying UBIT to "routine testing" except state and federal mandated testing and laboratory testing as a part of a student education training program.

The term "routine testing" needs to be further clarified. Health screening, in a well baby clinic, for example, could be considered routine testing. Free or low-cost pregnancy testing provided by prenatal care programs, testing for high blood pressure, diabetes, lead poisoning in children, hearing and visual and other conditions are sometimes done for a small fee. These programs provide widespread access to disease prevention and early diagnosis of illness.

For example, the state of Illinois requires all blood donations to be tested for the HIV virus which can cause AIDS if the Red Cross, or other such organization, should offer testing for traces of some other blood related diseases during the donation process (for a small fee), which are not required under state or federal law, they would probably have to charge a tax on this service. Such proposals could potentially have an effect on the overall blood supply.

We do not believe it is appropriate to exempt government in this case as it is easy to point fingers at problems in one sector and avoid the same in ones own jurisdiction.

United Way of Illinois suggests that an exception is needed for testing which provides access to services based on ability to pay for those who would otherwise not be able to obtain the service.

III. Regarding the Subcommitee's proposal to repeal the exemption for unrelated business income form activities that are not "regularly carried on."

Taxation of trade or business activities which are regularly carried on are appropriate however, the definition of what constitutes "regularly carried on" needs to be clarified. Occasional fundraising activities should not be taxed. An activity which is not often carried on does not constitute a competitive threat to for-profit activities. This provision in essence would tax charitable contributions.

Many charities hold annual fundraising events such as charity auctions, theater benefit nights, receptions and dinners etc. Under this proposal, the proceeds would be taxable. Although the current exemption for trade or business activities conducted substantially by volunteers would be preserved, it would probably not apply to many or most of these activities as activities are generally planned by volunteers but implemented by staff of the organization sponsoring the event or in some cases the for-profit enterprises engaged to carry them out.

For example: A local charitable service organization in a smaller city of Illinois annually holds a charitable art auction. A for-profit art gallery is contracted to provide the art pieces and auctioneer and the charity receives 20% of the sale. Purchaser of these art pieces are advised that only 20% of their purchase may be deducted as a charitable contribution. Under this proposal no part of the purchase could be deducted for a contribution and the charity would have to pay tax question: on what portion of the sale? This type of activity not only allows this community to provide support to a local charity providing services in their community but also provides them access to products they would otherwise not have available within their community and supports a for-profit enterprise at the same time.

The United Way of Illinois believes it would be more appropriate for the IRS to develop guidelines to identify when such activities become regular events and competitive with for-profit endeavors than to tax all charitable fund raising events.

IV. Regarding application of UBIT to all net royalty income or in cases where the nonprofit or a "closely related organization" created the property or provided substantial services or financial resources for developing or marketing it. Exempt products "directly related" to the exempt function.

We understand the desire to limit exemption for those activities which involve products that are competitive with for-profit endeavors in some circumstances. However, we are concerned that this proposal may inadvertently make income from charitable sales promotions taxable.

Many for-profit companies advertise to the public their support for the activities of a nonprofit organization and offer to make a contribution to the charity when its product is purchased or used. The charity benefits from not only the charitable activity but the company's publicity as well and in turn boosts public contribution to the charity. Under this situation, the contribution to the charity may be considered a royalty for use of the charity name. Also, using the charity's name could be construed as performing as service in marketing of the product although the charity has nothing to do with the creation of the product.

While United Ways generally do not engage in charitable sales promotions, these kinds of promotions have been a good way for expanding financial resources for charities and increasing public awareness of the important role charities play in our society.

Two examples of instances in which these kinds of situations have benefited a local United Ways come to mind. In one Illinois community a new pizza franchise was opening and, without contacting the local United Way, advertised that for every slice of pizza sold for the first week of their grand opening a donation would be made to the local United Way. Although no contact or arrangements had been made in advance with the local United Way organization, they were happy to receive the donation from the business promotion to help fund local human services.

In another instance, a new card and gift shop opened in the town. As part of their ongoing sales, they have pledged that 10% of each purchase by a customer will go to a local charity as designated by the customer. Although no local charity was contacted in advance of this small business's plans, the store owners claim they want to show support for the community and promote purchase of locally made products they have at the same time.

In these two examples, it was the decision of the business to promote themselves thru showing their support for the community. It would be terribly questionable in this type of circumstance, or even in one where there was advance notice to the charity by a business that they wanted to conduct such a promotion, to tax these sales promotion proceeds which and based on net income from the sale of the product. These type of promotions help many agencies overcome the loss of resources from federal funding cuts in their service programs.

United Way of Illinois recommends that charitable sales promotions be exempted from this provision.

V. Regarding the Subcommittee's option to increase the current exemption for the first $1,000 of UBIT to between $5,000 and $10,000 with a phase out above $50,000.

As we understand this proposal, the current $1,000 UBIT exemption would be increased to $5,000 however, the benefit of the exemption would be phased out above $50,000 in taxable UBI and is applicable to "certain" exempt organizations which are otherwise not defined. Which would not provide relief from filing a UBIT but only mean that minimal unrelated income would be free of tax.

Given the greatly increased scope of the tax that would result from adoption of the other options many charitable entities would find themselves newly subject to tax.

Due to staffing and related costs of filing a return, paying the tax and submitting to audit as well as the inflation rate over the last 38 years, the United Way of Illinois recommends raising the floor to $10,000.

VII. Concerning the proposal about controlled subsidiaries.

Although I am not aware of any impact on United Ways it appears that there is some question if "fairness" in that the proposal would prevent a subsidiary from deducting at its level payments of interest rents, and royalties which are normally deductible expenses of a taxable business.

Allocation rules comment

The question of "fairness" of application appears to also arise here as to the degree normal tax rules apply in calculating deductions against gross unrelated income for an organization's fixed costs of assets used in an unrelated business and other internal expenses of such business. If what is regarded as deductible costs for a normal business are not deductible by an exempt organization the effect would be a heavier tax on the exempt organization than on a taxable one.

IX. Expansion of form 990-T, for reporting UBIT activities and other revenue sources such as contributions and grants and expansion of information on revenue producing activities on the 990 for all exempt organizations.

The United Way of Illinois supports increased reporting on 990 and 990-T and efforts toward increasing identification of noncompliance. Many problems giving rise to the Subcommittee's discussion could be addressed by more vigorous application of existing law.

> We are pleased that the Subcommittee will study joint ventures before enacting any amendments in this area. The United Way of Illinois is especially concerned in this area as one of our main goals is to facilitate public/private/voluntary partnerships to solve local community problems. We believe that the state of Illinois has proved to be a leader in this area and would not want to in any way jeopardize the American spirit of joining together to address issues and areas of need.

We are pleased to have the opportunity to comment on the subcommittee's discussion options and hope we will have further opportunities to comment on the proposals as they take shape. However we cannot stress enough that many of the areas you are seeking to write into law can be handled thru rules, regulations and guidelines of the IRS and do not necessarily warrant changes in law. United Way of Illinois strongly recommends that you consider this option.

UNIVERSITY OF CALIFORNIA

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April 15, 1988

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

We appreciate the opportunity to comment on the discussion options released by the Subcommittee on March 31, concerning the unrelated business income tax. Since last summer, members of our staff have had the opportunity to meet with several members of your Subcommittee staff to exchange views and information about certain areas of particular concern in the unrelated business income tax area. Foremost among our concerns was preservation of the research exception and the importance of fostering technology transfer. We are encouraged that the discussion options do not address any changes to the research exception and commend the Subcommittee and its staff for the apparent retention of the research exception.

In preparing our response to the discussion options, we recognize the Subcommittee's efforts to consider and respond to the broad array of concerns embraced by the unrelated business income tax issue. Nevertheless, we believe that a number of the proposals warrant further review and have attached our comments on those particular options of concern to the University. While we have addressed the options in the order outlined in the press release, of special note are our points concerning the options dealing with allocation rules, treatment of royalties and the imposition of an entirely new standard to identify unrelated business activities, the latter which would create unwarranted administrative burdens and expense for the University (e.g., modification of the substantially related test and elimination of the convenience exception and regularly carried on standards). We are in substantial agreement with the position of the American Council on Education in its response to the Subcommittee's discussion options.

Thank you for the opportunity to comment to the Subcommittee's discussion options. We would be pleased to provide further information.

Sincerely,

Paul Sweet

Paul Sweet, Director
Federal Governmental Relations

Enclosure

UNIVERSITY OF CALIFORNIA RESPONSE TO HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT UBIT DISCUSSION OPTIONS

APRIL 15, 1988

THE "SUBSTANTIALLY RELATED" TEST

We strongly urge the Subcommittee to retain the "substantially related" test as it is currently applied. Although it may require some difficult judgments in specific cases, the present "substantially related" test is a workable and equitable standard. It allows colleges and universities to pursue their educational and other exempt purposes with minimal burden while discouraging the conduct of activities not related to those purposes.

Given the diversity of necessary and appropriate functions and activities undertaken by universities, a more stringent statutory standard such as a "directly related" test or a "stand alone" test for determining the exemption of income-producing activities would not be practicable. We concur with the American Council on Education (ACE) that replacing the current standard with a "directly related" test would merely constitute a change from one subjective standard to another and in doing so, we would lose the forty-year interpretive history behind the "substantially related" test. The Subcommittee's other alternative of requiring each income-producing activity to qualify independently for tax exemption appears to be equally unworkable. Universities carry on many different types of activities which contribute importantly to the accomplishment of educational purposes. However, if viewed in isolation, many of these activities such as the operation of college dormitories and laundries might not qualify as educational and could lose their exemption under this standard.

If the "substantially related" test is retained, the Subcommittee's list of options suggests that the UBIT be applied to specific activities which are "inherently commercial, rather than charitable." The conclusion that there is a class of activities which are "inherently commercial" is difficult to justify because the context within which an activity takes place determines whether there is an educational component or other relationship to the exempt purpose of the organization. Our comments on the options of most concern to the University of California are presented below.

Bookstore Sales

For most universities, the imposition of UBIT on bookstore sales will result in increased costs to the students for student programs and services. We strongly urge that a provision be made for an annual adjustment of the dollar limit for low cost items based on a consumer price index.

We also urge the Subcommittee to reconsider the option to apply the UBIT to all income from off-premise sales (in excess of some *de minimis* amount) without regard to the educational value of the items sold. It is doubtful that such a restrictive geographic test can fairly assess the peculiarities of all college and university campuses where bookstores are sometimes located off-campus and educational items are sold at satellite learning centers and extensions.

Medical Sales and Services

As written, this discussion option discriminates against certain classes of patients. We recommend, therefore, that the Subcommittee expand the exceptions listed under this option to include *all* patients.

University medical centers often treat patients referred by their private physicians on a one-time basis because of the highly specialized doctors and technically advanced procedures and facilities available at these hospitals. The taxation of sales and services to this group, therefore, would diminish the ability of university hospitals to provide these specialized and technically advanced services at reasonable costs to the community.

The exceptions also do not appear to provide for the exemption of sales and rentals of medical equipment to medical and dental students and faculty. These sales are integrally related to the training of these health professionals and should not be subject to the UBIT.

Veterinary Services

Although the taxation of income generated from elective veterinary surgery may be appropriate in some cases, we recommend that an exception be made for university veterinary hospitals where the provision of veterinary services is substantially related to research and the training of students.

Routine Testing

Medical tests should continue to be exempt for all classes of hospital patients. Moreover, many teaching hospitals provide medical tests which are unavailable elsewhere within a reasonable distance. These testing services should be exempt from the UBIT because they fulfill a vital community health need in furtherance of the hospital's exempt purpose. (See Revenue Ruling 85-110).

We support ACE's efforts to develop a statutory distinction between routine testing and testing activities that constitute research with its ancillary and incidental activities. To this end, we strongly urge the Subcommittee to adopt a statutory exception for the clinical testing of drugs for safety and efficacy in order to obtain government approval. Such clinical testing represents an important class of research activities that are closely and importantly related to the teaching and research functions of medical schools.

Advertising

The current law allows for the deduction of circulation or readership losses where there is an excess of advertising income over direct advertising costs. However, circulation losses cannot be used to reduce the taxable income of any other unrelated business activity of an organization. We support the retention of this full and equitable deduction of shared expenses. The imposition of an arbitrary limitation on the deduction of legitimate business expenses of tax-exempt organizations is contrary to the purpose of the law which is intended to place non-profit and for-profit businesses on the same tax basis.

For many colleges and universities, the sale of advertising space is a crucial activity that enables programmatic activities to occur and scholarly publications to be produced and disseminated. Without advertising income to help offset the expenses associated with the entire event or publication, many of these educational programs would not occur. Accordingly, it is appropriate to allow, as deductible costs against taxable income, the expenses associated with the entire event or publication.

THE CONVENIENCE EXCEPTION

The wholesale repeal of the convenience exception to correct perceived abuses would serve no purpose but to increase the administrative uncertainty of tax-exempt organizations in making judgments regarding the tax status of activities which legitimately facilitate campus life. Although many of the activities covered by the current exception may continue to be exempt under the "substantially related" test, other services conducted for the benefit of students may not be protected unless specific authorities are provided in the revised tax law. We recommend, therefore, that the convenience exception be retained but modified to specifically exclude those activities that do not merit exemption.

THE "REGULARLY CARRIED ON" TEST

We support retention of the "regularly carried on" test as a de minimis standard. Under present law, activities conducted on an infrequent or sporadic basis are not subject to the UBIT since they are not "regularly carried on" in a commerical manner. Accordingly, activities such as annual fundraisers and advertising in sports and cultural performance programs currently are not taxable, provided they are not systematically and consistently promoted.

Under the Subcommittee's proposal to repeal the "regularly carried on" test, such activities might become taxable unless they do not constitute a trade or business. We concur with ACE that the definition of a trade or business is not sufficiently clear-cut to make distinctions between activities which should be subject to the UBIT and those which should not. The University of California currently includes in its return (Form 990-T) many business activities which produce a modest level of income that are regularly carried on. Under the trade or business requirement, however, activities that produce any significant amount of income even if casually conducted would be subject to the UBIT. Consequently, the additional administrative effort required to file on every sale made for a non-exempt purpose would be unreasonable and burdensome. The cost of establishing an accounting system to comply with the proposed change would far exceed the income realized from those commercial activities conducted on an infrequent basis.

THE TAX TREATMENT OF ROYALTY INCOME

In general, we support the Subcommittee's option to apply the UBIT to royalties received in those situations where the tax-exempt organization effectively becomes an active partner in a business. We agree that income received in this manner loses its passive nature and should not be exempt from UBIT.

However, although the University of California does not enter into royalty arrangements based on a net-profits interest, we are concerned that the Subcommittee is attempting in this proposal to discriminate between licensing income based on net profits and that based on gross income. We can identify no difference in the relationship between the tax-exempt institution and its licensee whether the royalties are based on gross income or on net profits. In either case there is no controlling interest taken in the licensee company by the University. As the tax-exempt institution would not be an active partner in the licensee's business, its income should not be subject to UBIT.

We strongly oppose the application of UBIT to royalties derived from a tax-exempt organization's created property. It is not clear from the proposal how the Subcommittee intends to define "created property." The term could be defined as know-how (or specialized knowledge associated with a particular technology); patentable subject matter; and copyrightable works, but may or may not include trademarks.

By taxing created properties the Subcommittee would discourage technology transfer, and therefore national competitiveness, in direct opposition to historical Congressional intent and to the past eight years of legislation and presidential Executive Orders. Public Law 96-517 requires that any income derived from a tax-exempt organization's property created with any federal funding must be spent on education and further research. Taxation of that income would reduce the total amount available for carrying out the university community's mission and would reduce the University's incentive to invest in technology transfer.

We are uncertain what the tax treatment of trademark income would be under the Subcommittee's discussion options. Such licensing activity serves a legitimate university purpose substantially related to its tax-exempt activities. In the increasingly national and international scope of University activities, the modest and controlled use of its name in the commercial arena provides significant aid in preventing unauthorized, misleading, and damaging use by others. For this reason, we believe that income from trademark licensing should be excluded from UBIT.

Under the present Subcommittee proposal, know-how transfered to a business licensee could be interpreted as being a "substantive service" rendered to the licensee. It is our position that income received from know-how should not be subject to UBIT, in accordance with our remarks regarding "created property."

Public Law 96-517 requires that the University share with its inventors the income received by the University from licensing intellectual property. Similarly, the Federal Technology Transfer Act of 1986 provides that a federal employee inventor is also entitled to a share of the royalty income. The share of the income that the tax-exempt organization pays to its inventor acts as an incentive to creativity and is taxed as personal income. To tax the organization on total royalty income received before expenses and inventor shares are paid, would result in a double-taxation similar to the present corporate dividend tax structure and would reduce the amount available for inventors' shares.

The chilling effect of this proposal on both the inventor's creative role and on universities' educational efforts would severly limit the ability of research institutions to effect technology transfer. American competitiveness in the world market could be severely hampered as a result. We strongly urge the Subcommittee to reconsider this aspect of its proposal.

ALLOCATION RULES

Where facilities are used both to carry on exempt activities and an unrelated trade or business, the current law provides that expenses, depreciation and other items of overhead shall be allocated between the two uses on a reasonable basis.

We strongly oppose the proposal which would subject non-profit organizations to a heavier tax burden than taxable businesses. Tax exempt organizations must be taxed on the same basis as taxable business entities which are allowed to fully deduct depreciation and general administrative expenses.

The proposal advanced by the Internal Revenue Service (IRS) to curtail the deduction of overhead expenses attributable to taxable activities is not only at variance with the intent of the law but with previous IRS pronouncements on this matter. In its testimony before the Subcommittee, the IRS conceded that while it could be argued that no deduction at all should be allowed for fixed costs, "we are concerned that [such an approach] might unduly hinder the ability of exempt organizations to acquire new facilities..." Although the IRS disagreed with the allocation method upheld in the Rensselaer decision, the Service agreed that the purpose of the UBIT is "to measure the income attributable to an unrelated business and to tax it on essentially the same terms as other commercial activities."

ADDITIONAL REPORTING REQUIREMENTS

Although we would support expanded Form 990-T reporting requirements to include more information on taxable unrelated business activities, As a state university, we cannot support additional reporting on exempt activities and sources of revenue because of the constitutional considerations involved. We agree that not only the feasibility but also the legality of requiring state colleges and universities to file a general information return merits further study.

University of
Nebraska
Lincoln
School of Music

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(402) 472-2503

April 15, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I urge the greatest caution in eliminating the tax protection for non-profit organizations as described in the press release on "Unrelated Business Income Tax." Arts and other organizations have been hard hit by reductions in federal support, both because of direct loss of income and also by the increasing drain of the philanthropic section because of the large number of needy organizations seeking donors.

Non-profits and educational institutions have become entrepreneurs to survive. A sharply increased tax burden will cripple many agencies and organizations. I urge a very careful study of the impact of the proposals on the vitality of the cultural and artistic entities which are vital to our nation's quality of life.

Sincerely,

Kerry S. Grant
Director
School of Music

js

University of Nebraska-Lincoln University of Nebraska at Omaha University of Nebraska Medical Center

75 YEARS
Memorial Art Gallery
OF THE UNIVERSITY OF ROCHESTER

500 UNIVERSITY AVENUE
ROCHESTER, NEW YORK 14607
716-473-7720

March 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I'd like to take this opportunity to comment on the preliminary discussion options regarding the unrelated business income tax and how they might impact museums.

Specifically, adoption of the options related to the taxation of income produced by museum shops and restaurants will reduce our earned revenue significantly. Income from both our Gallery Store and Gallery Cafe restaurant represent important and critical sources of revenue for the museum. As is the case with most museums nationwide, the Gallery is trying to find ways to be more self-sufficient, rather than depending so heavily on contributed income. In Rochester, as well as across the country, reduced corporate support along with cutbacks in government funding have made is necessary for museums such as the Memorial Art Gallery to rely on their own resources to make up the balance.

Any significant reduction in our earned income would certainly result in a very unfortunate position for the Gallery--specifically, the **curtailment of services to the public.** In order to maintain a balanced budget, the Gallery could be faced with the prospect of cancelling educational programs, mounting fewer exhibitions, reducing the number of tours provided school children, and curtailing many other services that are so vital to maintaining a rich cultural resource for the Rochester community.

Theoretically, reductions in the income netted by museum stores could lead museum administrators to decide that it is not economically feasible to operate such enterprises. If the Gallery were to find itself in this position, a huge disservice to the Rochester community would result. Our Gallery Store sell artwork and art books (important educational resources) that are often not available elsewhere in the region. In addition, as the Store is an important outlet for the sale of local artists' wares, closing the Store would have a negative impact on these artists, and on our commitment to support the arts of the region.

Museum stores and restaurants are primarily operated for the enjoyment and use of the museum's members and visitors. Our Gallery Store and the Gallery Cafe restaurant provide necessary amenities to our visitors. We have found, too, that they are often responsible for attracting new audiences and repeat visitation to the Gallery.

The fact that these stores and restaurants also produce income is secondary in significance, but is becoming increasingly important as museums must find additional sources of support. I feel that to impose a tax on our earned revenue would be unfair and very damaging to our effectiveness as a cultural resource for the Rochester community.

I appreciate your consideration of these comments.

Sincerely,

Grant Holcomb

Grant Holcomb
Director

GH:cg

THE UNIVERSITY OF TENNESSEE

UT

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and Vice President for Development
605 Andy Holt Tower
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April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

We at the University of Tennessee have followed closely the deliberations of the Oversight Subcommittee on unrelated business income tax. We appreciate the difficulty involved in developing law and policy on this subject which protects those activities undertaken by tax exempt organizations in the interest of their basic mission while maintaining equity with the broader business community. While we still find substantial areas within the "options" now being considered by the committee which give us great concern, we feel much progress has been made since the first hearings last summer. We especially commend the subcommittee for removing the research question from the table.

In the short time available, we have not had the opportunity to undertake a comprehensive examination of these options. We know also that such an examination is underway within the American Council on Education, The National Association of State Universities and Land-Grant Colleges, and other Washington-based higher education associations. We also have joined with the Universities of Texas, Stanford, Duke, Harvard, and the University of Alabama, Birmingham, to make a proposal on a number of the topics which you are considering in these options. Your careful consideration of material you have received from all these sources is urged.

One overriding issue seems to lead to most of the specific problems which we face with this list. Many of us who work with the wide range of activities which have come under scrutiny had hoped that this effort would lead to a more clearly defined set of standards by which actions would be judged. In too many cases, however, I am afraid we are instead getting a list of specific cases which are allowed or denied. This approach may leave us bogged down in attempting to draw ever more narrow definitions to know if an activity is taxable or not.

On the one hand, we share your concern with the broad "convenience exception" and whether it is sufficiently defined. However, to remove it simply has the effect of removing the considerable body of case law which has been built up and causing us to start over on a case-by-case basis to define the "substantially related" test. Further, if you consider this in conjunction with your efforts to abolish or substantially change the "substantially related" test, we are even more uncertain. This in turn leads us to agree with your restriction on computer sales and tour and travel services but to be unclear about a wide range of other items.

Even in those areas in which we have substantial agreement--such as the limitations on durable medical equipment--we find ourselves faced with definitional questions. For example, would someone who comes at irregular intervals to a publicly supported clinic be in "continuous outpatient care"? Would a patient-referred inpatient status in the hospital to our home health agency be covered? These are important questions to our being able to know how to comply with this standard, if it should be adopted.

Similar questions arise in the providing of testing service. Section I-H combined with Section I-B answers the basic questions in regard to routine testing. However, because of the specific language of sub-section H, we could find ourselves involved in keeping separate accounts for those tasks performed by students and those performed by lab technicians.

Finally, we are deeply concerned in the area of royalties. I am attaching to this response a two-page memorandum prepared by the attorney who serves the University of Tennessee Research Corporation. This nationally acclaimed organization devotes its efforts to moving discoveries from our faculty into the marketplace. This activity is viewed by this University as part of the return on its investment which is due to the people of this state and this country for their support of research in a public university. A number of highly successful high-tech businesses are now contributing to the economy of this area, and to the tax stream at the local, state, and federal governments because of the activities of this organization. You can see from Ms. Roberson's thoughtful response that it is urgent we act in a way that enhances rather than threatens this effort.

We agree with your intent to secure more complete reporting of activities undertaken by exempt organizations. Although this will greatly increase our efforts necessary to comply, we feel it is necessary to know. We do not, however, believe that scattered anecdotal evidence of abuse of the present system should lead to reporting requirements so burdensome that needed services are foregone simply to avoid these requirements.

Again, we commend to your careful consideration the material which has been submitted to Chairman Pickle by the University of Texas, this university, and others. We are convinced it gives a first-rate starting place for consideration of this extraordinarily complex issue. Further, we stand ready to join with you and your staff in exploring ways to ensure basic equity without interfering with the mission of the tax exempt organizations which are so important to this country.

We appreciate the opportunity to comment on this issue.

Sincerely yours,

Joseph E. Johnson
Executive Vice President and
Vice President for Development

JEJ:alw
Attachment

To: Walter Lambert

UTRC The University of Tennessee Research Corporation

Suite 415 Communications Bldg.
Knoxville, Tennessee 37996-0344
Telephone: 615-974-1882

MEMORANDUM

TO: Dr. K. W. Heathington

FROM: Ann J. Roberson ajr

DATE: April 8, 1988

SUBJECT: Proposed Changes to Unrelated Business Income Tax

This memorandum considers the House Ways and Means Oversight Subcommittee Discussion Options for changing the "unrelated business" income tax and how those changes might affect UTRC's tax exempt status.

Since 1950, most organizations who have tax-exempt status have been taxed on "unrelated business income", defined as income from a regular trade or business activity which is not substantially related to the organization's exempt purpose. However, by definition, tax-exempt organizations are not currently taxed on income from "substantially related" activities.

Under an opinion of the Internal Revenue service in 1981, UTRC's income from patent and copyright activities was held not taxable as unrelated business income. The reason given by the IRS for this holding was that UTRC's income from these activities constitutes royalty income, which was excluded from tax under the Section 512(b)(2) of the Code, which provided that "[t]here shall be excluded [from 'unrelated business income'] all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions, directly connected with such income."

The Oversight Subcommittee's Discussion Options propose that the "substantially related" test be retained, but severely limited in scope by explicitly treating certain specified activities as unrelated (those which are "inherently commercial"), and therefore subject to tax. Among those activities which could be considered as "inherently commercial" (according to the Oversight Committee's report) include certain types of royalty income.

It is proposed that the following types of royalties would be taxed:

A. Royalties measured by net or taxable income derived from the property. (This definition apparently would allow royalties measured by "production" or by "gross income" to continue to enjoy tax-exempt status, although that is not specifically stated.)

B. Royalties received by an organization for use of property if such organization, or closely related organization either:

    (1) created such property, or

    (2) performed substantial services or incurred substantial costs with respect to the development or marketing of such property.

Under this proposal the following types of income would continue to enjoy tax-exempt status:

(i) Royalties from certain "non-working property interests" (such as oil wells);

(ii) Royalties from products directly related to the exempt function.

It is possible that royalties received by UTRC could be taxed under this proposal under alternative A, which provides that royalties will be taxable if measured by "net" or "taxable" income. Royalties accruing to UTRC from licensing of intellectual property are generally measured in terms of the licensee's "net" income. However, UTRC's definition of "net" income is not analogous to the licensee's "profit" or taxable income. Therefore, an argument might be made that UTRC's royalty income does not fall under this section, but a definitive answer is impossible to give without a determination of what constitutes "net" income.

UTRC's royalty income could also be determined to fall within the parameters of the first prong of alternative B, which provides that royalties will be taxable if received for the use of property created by the subject organization or a closely related organization. UTRC receives royalty income on intellectual property created by The University of Tennessee. Therefore, the applicability of this section to UTRC probably depends on whether or not The University of Tennessee is considered a "closely related organization." Again, a more conclusive answer would require that the term "closely related organization" be defined, which it currently is not.

The third basis under which UTRC's royalty income might be taxed under this proposal is the second prong of alternative B, which provides that royalties will be taxed if they are received for use of property which the organization (or a closely related organization) performed substantial services or incurred substantial costs with respect to the development or marketing of such property. The taxation of UTRC's royalty income under this test would also require a finding that The University of Tennessee is a "closely related organization." Assuming that such a determination were in fact made, the question would become whether UT (or UTRC) performed substantial services or incurred substantial development or marketing costs. This could potentially lead to the taxation issue being resolved on the basis of whether a faculty member invented the royalty-bearing product as the result of long, arduous, and expensive research (in which case the royalty income would arguably be taxable) or whether the faculty member invented the product in a flash of brilliance involving no "substantial" development costs (in which case the royalty income owuld arguably be exempt from tax, if there were no other substantial marketing or development costs).

In summary (and for the moment putting aside questions of semantics), it appears that the intent of these proposals is to tax income resulting from intellectual property (including patents and copyrights) developed in the course of an exempt organization's operations. This would obviously be disastrous for UTRC from a tax standpoint inasmuch as our income currently results primarily from royalties received on the licensing of intellectual property resulting from the University's research and development activities. I strongly suggest that all appropriate measures be taken to prevent the passage of such legislation, if possible.

NOTE: There are other issues presented in the Oversight Committee's Discussion Options which might have an effect on UTRC. However, upon a brief review, those issues appear to be less important from our point of view in that (as currently drafted) they are less likely to substantially impair, or completely remove, UTRC's tax exempt status.

Analysis of Oversight Subcommittee Discussion
Options on Unrelated Business Income Tax
The University of Texas System

GENERAL OBSERVATIONS

The discussion options represent a starting point for developing modifications to the unrelated business income tax that will address the concerns expressed by both the small business community and the non-profit sector.

We are particularly pleased that the paper leaves the research exemption intact. We believe it to be good public policy to continue to encourage the discovery and dissemination of new knowledge.

We support efforts to modify the law to address the activities of non-profits that have caused concern, but the structure of the paper is cumbersome and is likely to result in numerous unintended results. It proposes the repeal of the convenience exception and then limits the effect of the repeal by providing specific exemptions from UBIT for numerous activities which have historically been covered by the convenience exception. This would create great uncertainty and increased litigation as non-profits, the IRS and the courts interpret this change.

A simpler and more effective approach would be to retain the convenience exception and specify those activities to which the convenience exception would not apply.

The following are our comments with respect to each specific proposal. We have commented only on those provisions which appear to have material impact on The University of Texas System.

I. Substantially Related Standard

The discussion paper suggests three apparently mutually-exclusive options: (1) replace the "substantially-related" test with a "directly related" test; (2) determine whether each income-producing activity standing alone is tax-exempt; or (3) retain the "substantially related" test while imposing UBIT on specified activities whose nature and scope are considered inherently commercial. The discussion options do not attempt to define the "inherently commercial" standard, but list certain activities, many of which are currently addressed by the convenience exception.

We have no guidance to interpret the first two options. However, it is apparent that creating a new standard of "directly related" would result in tremendous uncertainty and litigation. Conceivably the provision could be interpreted to mean that only activities of a university such as classroom instruction would be considered "directly related" until further guidance is provided by the courts. We do not believe this is what Congress would intend. As stated earlier, many of the activities examined at the hearings can be better regulated through modifications to the convenience exception.

The option to make a determination whether each income-producing activity standing alone is tax-exempt would appear to be a restatement of current law and administrative practice.

Regarding the third option, retaining "substantially related," while imposing UBIT on specified activities considered to be "inherently commercial," we believe it to be preferable to establishing any new standard such as "directly" related." However, the "inherently commercial" concept is inappopriate in that it seeks to restrict certain activities of non-profits simply because they appear to be analagous to for-profit activities. The test should be whether the activities are substantially related to the organization's exempt purpose. The specifics of this option are discussed below:

A. Gift Shops and Bookstores

1. In general

a. On-premise sales: Apply UBIT to the sale of gift shop items except low cost mementos, articles of educational nature, guides to events or exhibits, and articles purchased from hospital gift shops generally used for patients.

Comment: This provision would create enormous administrative and bookkeeping burdens for gift shops at U.T. medical facilities and museums, such as the Huntington Gallery at U.T. Austin. They would have to drop certain legitimate items or develop a sophisticated tracking system to separate taxable and non-taxable items, including developing a methodology for estimating net profit on specified items.

According to an example in the paper, an art museum would be restricted to selling materials about items in its collections, instead of, for example, books about art in general. This is a severe redefinition of the mission of a museum, which has traditionally been assumed to be the broadest possible dissemination of information. "Articles of an educational nature" should include low-cost items relevant to the organization.

Regarding hospital gift shops, the option appears to be an attempt to retain an exception to the total repeal of the convenience exception in this narrow area.

It refers to articles purchased from a gift shop "of a nature generally used by or for inpatients of the hospital." This should be clarified in order to make it clear that the items need merely be "of a nature" used by or for inpatients, and not purchased for actual use by or for the patient. Without such a clarification, this would be a difficult provision to administer, as it would require the shop to keep records of both the nature of the item sold and the identity of the purchaser.

For example, the sale of a candy bar to a physician could, under the proposal, be subject to UBIT, whereas the sale of the candy bar to or for a patient might not. The exception might be better expressed in terms of a blanket exemption for hospital gift shop sales, with perhaps a dollar cap on individual items, or at least a broader category of exempt items (to include, for example, items which might be sold to hospital visitors and staff for use or consumption on the premises).

If the proposal is to be adopted in substantially its present form, at a minimum the list of excepted items in the example should be expanded to include additional categories of items such as reading and writing materials, toiletries, food items, etc.

b. Off-premise sales: Apply UBIT to income from all mail or phone order sales, where such income exceeds the amount of earnings from on-premise sales.

Comment: This proposal would apply UBIT to the sale of items which are related to the seller's exempt purpose based simply upon the method of sale. It would devastate the University of Texas Press. Most U.T. Press sales are catalog sales, because it seldom publishes general interest titles of the type carried by retail book stores. University presses seldom compete with commercial publishing houses; instead, they supply scholarly or narrow-interest titles to a limited--but international--market.

Items related to an organization's exempt purpose should not be subject to UBIT regardless of whether they are sold on the organization's premises or through mail or telephone solicitations. We would support legislation tightening the definition of such items to exclude items marketed for purely commercial reasons, but not simply because of the method of sale.

2. College Bookstores

   a. Apply UBIT to all sales unless items are in furtherance of educational purpose or items with a value below a specified dollar limit.

Comment: This option has been the subject of the largest number of complaints from our campuses. Our business officers believe the actual number of items restricted by it would be minimal, but that "it would create a bookkeeping nightmare" far in excess of any public policy benefits.

Many college students reside on campus in locations inconvenient to retail establishments, and it is in keeping with a university's educational purpose to maximize "study time" by minimizing the time students are required to spend in purchasing routinely needed items.

The current standard imposed by the IRS which is reflected in General Counsel's Memorandum 35811 (May 7, 1974) considers the type of goods sold and the degree of remoteness of the campus from vendors of the goods in question. The sale of items such as food, books, magazines, notepads and other consumable products should be, and currently are, exempted from UBIT, while durable goods such as television sets and refrigerators are and should continue to be subject to UBIT. To facilitate this result it is important that any dollar cap be set at a reasonable level.

A more appropriate--and less cumbersome--alternative would be to clarify the convenience exception to exempt from UBIT the sale of goods with a useful life of less than one year, while developing an exception for geographically-remote campuses.

   b. Apply UBIT to the sale of computers to persons other than students or faculty members--also limit exemption from UBIT to the sale of one computer per year per student or faculty member.

Comment: We support a policy of taxing computer sales to the general public and limiting sales to one a year. However, in many ways, university scientific, technical, professional, and administrative staff are as productive and as important participants in the education and research activities of the "university community" as are faculty and students. We recommend that computer sales to staff be added to the exemption proposed for faculty and students.

B. Medical Equipment and Devices, Laboratory Testing, and Pharmaceutical Drugs and Goods

UBIT would be imposed on all sales or rentals of medical equipment, laboratory testing, and pharmaceutical drugs and goods. Sales to inpatients and "continuous care or emergency treatment outpatients" and sales of items not available in the immediate geographic area would be excepted.

Comment: This proposal appears to be aimed at restricting sales and services to "walk-ins" who are not patients of the hospital. We concur that hospital sales and services should be restricted to patients of the hospital. However, this option goes much further than that. While it is not clear what will constitute a "continuous care or emergency treatment outpatient," this appears to inhibit sales to outpatients generally. It would also appear to tax goods and services at our student health centers, which we do not believe is the intent.

This is again an area where an exception is being carved out of the proposed total repeal of the convenience exception, and again the carveout is too narrow. The law currently would tax sales of such items to persons who do not have or have not had a patient relationship with the selling organization, but would permit sales to outpatients whether or not they qualified as "continuous care" patients. It is important to understand that outpatients are not "walk-ins," but patients who are on the premises to receive treatment.

Both state and federal policies have encouraged a shift toward increased outpatient care as a cost containment mechanism. The sale or rental of items related to a patient's care at a hospital or clinic is in fact a matter of convenience to both the patient, in being able to purchase or lease the items on the hospital or clinic premises, and to the prescribing physician or therapist, in being able to direct the patient to a local facility that stocks the precise item called for in that patient's treatment.

We support a clarification or amplification of current law restricting these activities to individuals receiving treatment at the hospital--as either inpatients or outpatients. It should also be made clear that patients entitled to services at student health centers--not the general public--would be exempted.

Another example of the impact of this proposal may be found at the Callier Center at U.T. Dallas. The Center trains audiologists, and as part of this training the students are taught to prescribe and fit hearing aids, which requires dispensing hearing aids. Under the proposal, the dispensing of hearing aids by the Callier Center would be subject to UBIT despite the fact that such activities are an integral part of the University's educational mission.

Similarly, our medical schools train students in the fitting of prosthetic devices. If the University cannot dispense prosthetic devices, it cannot train students to fit them for patients. An exemption should continue to exist for sales in furtherance of an educational function.

It should also be made clear that laboratory testing, which is part of an educational training program, will continue to be exempt from UBIT.

C. Health, Fitness, Athletic and Recreational Activities

Apply UBIT to income from health, fitness, athletic and recreational activity unless the facilities or activities are available to a reasonable cross-section of the general public, such as by scholarships or fees based on community affordability.

Comment: This proposal is presumably directed at fitness-type programs and is not directed at hospital-provided health care. At a minimum, the provision should be tailored so this will be clear. Further, the law should not be changed to subject health care programs to UBIT where they are educational in nature and therefore in furtherance of the educational purposes of their sponsor. Educational health activities sponsored by a university are clearly related to its exempt function and should not be taxed.

The proposed requirement that facilities or programs be made available to a reasonable cross-section of the general public has merit, but a sliding fee schedule based upon one's ability to pay would be extremely burdensome to administer, particularly for small organizations.

Further, at least in the case of state universities which are making excess athletic facility capacity available to the community, an exception might be desirable. If memberships or the right to use facilities such as a university swimming pool require a great deal of overhead to establish and administer, the facilities will simply remain closed when not being used for training athletes or the physical fitness of students, and the public will lose a valuable benefit.

The typical university situation is likely to be different from that described in the example where members could gain access to an exclusive area only through payment of a special fee.

D. Travel and Tour Services

Apply UBIT income from all travel and tour services except those provided for faculty and students as part of a curriculum in a degree program. An exemption for de minimis sales to non-students and non-faculty is provided.

Comment: This is another proposal which attempts to limit the total repeal of the convenience exception. The proposal has merit in that it recognizes the necessity for travel services in connection with university activities, but it is too restrictive in limiting the UBIT exemption to travel services which are part of a curriculum in a university's degree program.

A significant part of a college education is based upon a student's extra-curricular activities and his or her exposure to people and places which may not be at all related to the award of a degree. A university related travel service should be able to provide travel assistance to students, faculty and other related persons (e.g., family members of students and faculty) where the travel is related to any educational function of the university. (A literal reading of the curriculum/degree requirement would mean that income from travel services provided to athletes traveling to intercollegiate competitions would be taxable; surely this is not an abuse which requires correction.)

E. Restaurants and Food Services

Apply UBIT to income from adjunct food service sales unless such services are provided on the premises of the organization and are primarily for the benefit of students, faculty, customers or employees of the organization.

Comment: This proposal should be clarified so that food service provided to off-campus activities which are University related (e.g., if the Union were to cater a dinner for a student organization) are not subject to UBIT. This clarification should also provide for a specific exemption from UBIT application for the sale of food items at athletic and cultural events sponsored by an exempt organization regardless of the location of such event.

H. Routine Testing

Apply UBIT to income from routine testing with exceptions for activities mandated by state or federal government and laboratory testing which is part of a student educational program.

Comment: Testing services provided to third parties or non-patients are presumably exempt under the proposal where they are conducted as part of the academic, technical, or clinical education of a student. However, this portion of the proposal should be clarified to make clear that it applies to testing conducted in connection with the education of students, and not necessarily by the student. Further, the example refers to the education of medical students, and it should be made clear that this applies equally to all students whose education requires the ability to perform or interpret such tests.

The proposal appears overly broad in that it could subject diagnostic procedures and other routine testing provided to hospital patients to UBIT. (While I.B. of the Discussion Options exempts laboratory testing for inpatients and certain outpatients, it is unclear how these two provisions relate.) This is probably not the intent, but it should be made clear that tests performed by a clinic or hospital for its own patients should not be subject to tax, whether such patients have been admitted or are being treated on an outpatient basis.

An example of the potential problems with the proposal is our M.D. Anderson Cancer and Tumor Center in Houston, one of the world's renowned cancer research centers. Patients must be subjected to a large number of tests, particularly those on chemotherapy, but, because diagnostic testing could appear to be covered by this provision, these tests would be subject to UBIT, under a broad interpretation of this provisions. M.D. Anderson does not train any medical students, so none of the essential testing conducted at that facility could be considered part of a student educational program.

J. Advertising Income and Cost Allocation Rules

1. Advertising Income

Apply UBIT to income from advertising in general.

Comment: This proposal would appear to subject all advertising income to UBIT. However, the most dramatic--and disturbing--change would be in the treatment of student newspaper advertising, such as The Daily Texan at U.T. Austin. In the context of the University, journalism and other students sell advertising for publication in The Daily Texan, and their participation in this activity is an important part of the educational process. As such, it should not be subject to UBIT. An exception should be crafted which exempts income generated from the sale of advertising where such sale is in furtherance of an organization's exempt purpose.

2. Advertising Cost Allocation Rule

Allow only costs directly connected with the sale and publication of advertising as an offset to advertising revenues.

Comment: This proposal unfairly attempts to isolate one element of an intrinsically integrated operation and subject it to UBIT. If there were no circulation, there could be no advertising revenue, since advertisers are paying for the exposure of their product or service to as many readers as possible. In the case of The Daily Texan, where there are only a few hundred paid subscriptions among its 38,000 or so daily circulation, it would be impossible for the publication to recover any but a minute portion of its costs of circulation, while all of its advertising income would be taxed. This treatment does not create parity between taxable and tax-exempt publications, but shifts the balance tremendously in favor of the taxable entities, who must pay tax on their income only if their total revenues from advertising and circulation exceed their total costs of publication.

II. Convenience Exception

The proposal would eliminate the current rule that a trade or business conducted by a Section 501(c)(3) organization or state university is exempt from UBIT if it is operated primarily for the convenience of members, students, patients, officers, or employees.

Comment: This is the most fundamental change in the proposal. It would overturn decades of IRS and judicial guidelines and and undoubtedly result in a great increase in administrative and judicial proceedings to define new parameters for all organizations that provide goods or services.

The paper would transfer a number of activities now covered by the convenience exception to the relatedness provision. In doing so, it would put hundreds of innocuous university activities not specifically enumerated under the relatedness standard at risk until the IRS established new precedents and guidelines. The proposed repeal of the convenience exception is overkill, as is clearly demonstrated by the numerous attempts to reinstate some modified form of the exception in several areas (e.g., hospital gift shops, university bookstores, food services and travel services, etc.).

The convenience exception is especially important in the context of a university, as it enables it to provide an appropriate climate and environment for the education of its students.

IV. Royalty Exclusion

Apply UBIT to royalties measured by net or taxable income derived from property if the recipient organization created such property or performed substantial services or incurred substantial costs with respect to the development or marketing of the property. Exempted from UBIT application are non-working property interests and royalties from properties directly related to the exempt function.

Comment: It is unclear how far this provision is intended to reach in the area of research results and other intellectual property. Assuming that the "inherently commercial" standard would apply, it can be assumed that the majority of research initiated with no commercial application in mind would be exempt. This distinction would be cumbersome and difficult to determine, especially at the initial stages of a research project.

We feel it would be poor public policy to tax royalties from any research results or other intellectual property resulting from university research or education activities. State and federal government are encouraging universities and industries to work together to bring laboratory results to the public. Technology transfer of this type is vitally important to our national efforts to regain our competitive edge.

We are pleased that the exemption for non-working interests would appear to cover mineral royalties, which are an important source of endowment income for The University of Texas System and many other institutions.

The examples also provide that income from the licensing of a university's logo would give rise to UBIT. Since institutions own the rights to their own logos, it cannot be said that licensing these logos is in competition with any private business concern. The passive activity of licensing the use of a university logo for sale by others does not rise to the level of conducting a trade or business, and should not be treated as such.

VIII. Allocation Rules

With respect to facilities used for exempt purposes as well as unrelated business purposes, allow a deduction against unrelated business income for a proportionate share of the direct operating costs of the facility, but not allow a deduction for any of the depreciation of the facility or for a share of the general overhead of the organization.

Comment: This proposal expressly disallows a deduction for depreciation for facilities which are used for unrelated activities. For example, none of the depreciation of a multi-use auditorium would be allowed as a deduction against any unrelated business income generated.

This proposal is more restrictive than the current IRS position that depreciation and other indirect expenses of facilities used for both related and unrelated activities are to be allocated on a reasonable basis. The IRS has argued that the proper basis for such allocation is the actual use of the facility. The U.S. Court of Appeals for the Second Circuit held in Rensselaer that the proper basis is the available use of the facility.

The Discussion Options approach disallows a deduction for an expense which is obviously a cost of generating the unrelated business income. This is inherently unjust and does not create parity between taxable and tax-exempt entities, but rather gives a tremendous advantage to taxable entities which are allowed a full deduction for the depreciation of their facilities.

The paper also disallows a deduction for any part of the general overhead of the institution as a whole. As with the disallowance of a deduction for the depreciation of facilities used for both exempt and unrelated purposes, this proposal disallows a deduction for an expense which is obviously a cost of generating the unrelated business income.

A proportionate share of general overhead costs will almost certainly be less than the direct costs which a multi-use facility would have to incur to obtain the same services provided by the University (security, personnel, administration, payroll, etc.), and thus the UBIT in such a situation would not likely be less than income tax paid by a for-profit owner of such a facility. There is therefore no policy reason for eliminating this deduction.

IX. Tax Information Report/IRS Administration

A. Reporting

1. Expand Form 990-T reporting requirement to include more information on activities and income which the organization claims to be exempt or excluded from UBIT and all revenue sources.

Comment: A state college or university is required to file Form 990-T if it has gross income from an unrelated trade or business of $1,000 or more. Gross income is defined as gross receipts less the cost of goods sold and the cost of operations.

We support additional reporting requirements. However, as written, this reporting requirement would impose a tremendous burden on an institution like The University of Texas System. We would be required to analyze every activity and determine (and report) why it is exempt from UBIT. The cost of such analysis, as well as the cost of preparing such a report, would be enormous. Such a cost would be ultimately borne by the taxpayers.

There would be a substantial penalty imposed on state colleges and universities that have $1,000 of gross income from an unrelated business, that penalty being the cost of preparing the Form 990-T.

As an alternative, we recommend that representatives of state colleges and universities assist the IRS in developing an information reporting system which utilizes to the maximum extent possible the existing, standardized accounting formats common to state institutions. For example, The University of Texas System prepares intricately detailed budgets and financial reports for review by the Legislative Budget Board and the State Auditor. Those reports reveal all of the revenue-generating activities of the System, and could be conformed to meet a reasonable IRS reporting requirement at a substantially reduced cost.

C. **Studies**

Recommend that the IRS conduct the following study and report on:

1. non-profit exempt hospital reorganization;
2. exempt organizations that file Form 990 but do not file Form 990-T;
3. feasibility of require state and land grant universities to file an information return;
4. use, purpose and effect of joint ventures; and
5. study after five years on effect of UBIT changes.

Comment: We support efforts to gather more information on the nature of revenue-generating activities of non-profit organizations. If a study is made of the feasibility of requiring state universities to file information returns, then, pending the conclusion of the study, those institutions should not be required to file the returns called for in IX(A)(1).

April 14, 1988

Designated Contact:

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April 15, 1988

Robert J. Leonard, Esquire
Chief Counsel
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

This letter will respond with comments on behalf of Vanderbilt University on the Subcommittee on Oversight's press release of March 31, 1988 in regard to discussion options relating to the unrelated business income tax.

The underlying principles of Sections 511, 512, 513, and 514 are sound and should be preserved, and in several important ways the discussion options imply agreement with those principles.

As the Subcommittee on Oversight considers both the fundamental question of the need for any legislative attention in this area and the specific discussion options that have been presented, we urge that the need for change in the unrelated business income tax provisions be analyzed on the basis of comprehensive and reliable data. We understand that the Internal Revenue Service is in the process of a data collection effort that was begun last fall and, indeed, Discussion Option IX calls for specific studies to be conducted on five specific topics. We believe that the legislative process in examining the need for change would be greatly enhanced by first having available these studies and data. Without it, there seems to be a high probability that the legislation will significantly damage universities.

Across a broad spectrum of activity, the non-profit sector, particularly higher education, generates both present and future economic potential for the American profit sector. The contribution that higher education makes to the economic competitiveness of the United States very greatly outweighs any evidence of unfair competition with the profit sector that has been shown. It will never be possible to legislate in a way that eliminates complaints, and in the case of the unrelated business income tax there will inevitably be occasions where similarity of activity between the profit and non-profit sectors creates tensions and complaints.

The following comments, identified by the numbers appearing in the press release, represent our effort to address discussion options that appear to have particular relevance to Vanderbilt University. We note that the discussion options are not phrased in legislative language, and, in many instances, the effect of these options could vary significantly depending on the actual language used to implement them. We also note that because of this it is difficult to discern reliably the effects, both intended and unintended, of some of the discussion options and we encourage the Subcommittee to proceed deliberately and with ample discussion and comment.

Since the discussion options do not contain specific modifications to the research exception contained in present law, we assume and hope that the Subcommittee's intention is to leave this exception intact and that the Subcommittee recognizes the importance of the exception to economic development generally, as well as to colleges and universities and other exempt research organizations. Other proposed changes in the law, however, particularly the modification of the "substantially related" test, could have a very detrimental effect on the scope of the research exception. We urge that care be taken to preserve fully the research exception as it exists under current law. Similarly, we assume that other specific exceptions contained in current law but not addressed in the options will be preserved.

I. "Substantially Related" Test

First, we urge that the Subcommittee not adopt its first option of repealing the "substantially related" test and replacing it with a "directly related" test. While neither test is susceptible to precise definition and application, existing experience and holdings with regard to the "substantially related" test have established that it is workable and provides a body of useful interpretation. While not intended by Congress, a "directly related" test, if aggressively applied by the Internal Revenue Service, could be used to attempt to tax a large proportion of all activity that exists within an institution of higher education. Put another way, with the exception of the direct teacher/student relationship that exists in the classroom, there would be room for discussion and argument about the direct relatedness of a large spectrum of traditional university activity of cultural, residential, social, and indirect educational character that is by tradition and current practice an integral part of the college experience.

We also urge the Subcommittee not to apply a test of whether each income-producing activity standing alone is tax-exempt. As in the case of the effort to apply a "directly related" test, the application of a stand alone test could be reduced to a troublesome process producing unintended results. Inevitably, some activities within the non-profit sector that could be captured and contained in an accounting framework could be held to be non-exempt. It is neither reasonable nor practical to require, in an across-the-board way, that each component activity of a non-profit organization must meet the test of tax exemption, especially if legislative language were to be adopted that allows the Internal Revenue Service to fragment specific activities until the case can be made for non-exemption of a particular component of an activity.

If changes are enacted that would affect the "substantially related" test, we believe that the third option, the retention of the "substantially related" test, should be pursued with specification of particular activities that would be taxed. Whether the phrase "inherently commercial" is the right description that would allow for efficient administration should be carefully considered by the Subcommittee.

A. Gift shop/bookstore income

The bookstore at Vanderbilt University, and at many other colleges and universities as well, serves as an educational resource for the University. The bookstore contains required textbooks, reference books and ancillary material that support the intellectual life of the University. The Vanderbilt Bookstore is centrally located on the campus and carries a range of items that enhance and facilitate campus life. The convenience of the location saves time and trouble for students. Only a relatively small inventory of items unrelated to the academic environment is offered.

This option indicates that the Subcommittee will consider an exception to UBIT for "articles in furtherance of educational programs", or "low-cost items". We are concerned about what the definition of "low-cost" items might be, and more importantly, we are concerned about the limitation of the exception to "articles in furtherance of educational programs", another undefined term. Taken to an extreme, this provision could require the bookstore to monitor purchases by all patrons to determine whether or not the items purchased were for use in a course or for personal use. Taken literally, this provision would also result in the imposition of tax upon the purchase of items that are educational in nature but are not directly related to particular courses offered by the University.

For example, the bookstore carries self-improvement books, writing style manuals, calendars, dictionaries, and similar items, all of which are related to education in the general sense, but are not necessarily used in connection with particular educational programs.

The sale of dormitory living needs (sheets and spreads, lamps, and other sundries) and health and personal care items should also be an exception to UBIT, whether considered to be a convenience or to be directly related to a student's ability to pursue education. Vanderbilt has a large, residential campus; undergraduate students are required to live on the campus with very few exceptions granted. As a result, over 5,000 students live on the campus in university provided housing. The bookstore provides a convenient location for students that requires neither transportation nor pedestrian crossing of heavily travelled streets.

B. Medical equipment and devices

We believe that if UBIT is to be applied to sales or rental income of medical equipment and devices the exceptions should be as stated, except that sales or rental to out-patients should be exempt without the need to determine if they are "continuous-care" or "emergency" out-patients.

Provision of medical equipment and devices, laboratory testing and pharmaceutical drugs and goods are important services that hospitals provide to patients receiving care on an outpatient basis as well as patients recently discharged from the hospital. Due to the relationship between the patient and the hospital as the primary caregiver, patients often feel more comfortable purchasing these goods and services from the hospital than from an entity with which they have no association. While it may be appropriate to tax sales, rentals and services provided to non-patients, the application of tax to outpatients of a hospital is contrary to the fundamental basis for granting tax exemption to non-profit health care providers.

C. Health, fitness, exercise activities

Application of UBIT to income from health, fitness, exercise and similar activities should, if enacted, be subject to at least the same exceptions for in-patients and out-patients as described in paragraph B and for students, faculty and staff.

E. Ajunct food sales

It should be clear that the exemption for adjunct food sales extends to income from the sale of concessions at events such as athletic events, cultural performances, and other events related to a University's exempt purpose.

H. Routine testing income

We are uncertain as to the Subcommittee's intent with regard to application of UBIT to "routine testing," and whether this term is being used in the context of patient care or research, or both. If UBIT is to be applied to routine testing income, in addition to the exceptions proposed we believe that, as is the case under present law, income from tests for in-patients, out-patients, and for those kinds of tests not available in the immediate geographic area should be exempt.

J. Advertising income

We believe that UBIT should not be applied to advertising income for those activities and publications that are "substantially related" to an exempt organization's purposes. If UBIT is applied to that income, deductions for related costs other than the direct advertising costs should be allowed. Examples of the limited advertising that takes place at Vanderbilt are the student newspaper, The Vanderbilt Hustler, the student magazine, Versus, and athletic event programs.

L. Inherently commercial activities

It is not clear to us that the phrase "inherently commercial" is susceptible to a definition that makes it a helpful determinant of tax status. We appreciate the difficulty that the Subcommittee doubtless has encountered in defining a test for this purpose, and believe that the difficulty underscores the desirability, insofar as possible, of leaving in place present definitions and provisions. To provide one illustration of the problem of applying an "inherently commercial" test, we note that there are a number of activities traditionally carried on in the non-profit sector, and traditionally determined to be tax-exempt, that have attracted interest from the profit sector and resulted in the offering of goods and services by the profit sector in selected pockets of profitability. It could be argued that when this occurs a particular activity becomes inherently commercial and yet we believe that would be illogical and inappropriate.

II. Convenience Exception

We do not believe that the convenience exception should be eliminated. If it is to be eliminated, a clearer definition of "related" activities will be required as well as extensive provisions regarding safe harbors and exceptions to application of UBIT. Under current law, many activities conducted by exempt organizations are exempt from tax either because they are substantially related to the organization's exempt purpose or because they are provided for the convenience of members of the organization, and it is not necessary to determine precisely upon which basis the exemption from tax is allowed. If the "convenience" exception is removed, the exact scope of the "relatedness" test will become much more important.

For example, at colleges and universities, the provision of meals, dormitory space, and laundry facilities is a convenience to students, but these services are also directly related to the students' ability to pursue an education. Similarly, the sale of health and personal care aids and pharmaceuticals to students could be determined to fit both categories of exemption. Are charges for photocopying educational materials exempt under the relatedness standard or the convenience exception? Is the provision of athletic and recreational facilities and equipment related to education or convenience? The rental of rooms to families of patients in the hospital could be defined as being related to provision of health care as well as being a convenience to patients and their families.

These are examples of many activities that will need to be clarified if the "convenience" exception is repealed. The uncertainty as to whether these various sales and services are presently excluded from UBIT because they are directly related to the organization's exempt purpose or because they fall under the "convenience" exception will create uncertainty and lead to frequent dispute unless adequately addressed by legislation.

III. "Regularly Carried On" Test

It should be made clear that this change is not intended to render subject to tax fund raising activities, such as charity auctions, balls, benefit performances, etc.

IV. Tax Treatment of Royalty Income

Application of the tax on royalties for patents or copyrights resulting from research performed by universities would be contrary to the purpose of granting tax-exempt status to the exempt organization for the purpose of performing research. Much of the research of a scientific nature performed in this country is by exempt organizations because they are the ones able and interested in undertaking this research. In many instances, the research performed by these organizations is of a type that no commercial enterprise would have any interest in performing. If institutions are to be taxed on royalties derived from their research, there will be a diminished incentive to perform research across a broad range that includes a disproportionate amount of research returning no revenue at all.

In addition, the tax should not apply to the sale of the right to broadcast an athletic event or artistic performance sponsored by an exempt organization. These functions are related to the exempt purposes of universities and colleges, and the proposed legislation should explicitly exempt such income from UBIT.

VIII. Allocation Rules

With regard to facilities used for exempt purposes as well as unrelated business purposes, in addition to the deductions suggested by the Subcommittee we believe that deductions should be permitted for a share of the general overhead of the organization and for depreciation. Not to provide these deductions would be punitive to the not-for-profit sector and subject the not-for-profit sector to a greater tax burden than the for-profit sector. We believe that there is no basis or rationale for doing that.

Thank you for the opportunity to comment. We would welcome the opportunity to discuss these options further and hope that an opportunity will be available as the Subcommittee on Oversight continues its work.

Sincerely,

Jeff Carr
Vice-Chancellor for University
Relations and General Counsel

JC/kd

Victoria Society
of Maine

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109 Danforth Street
Portland, Maine 04101

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

April 12, 1988

Dear Mr. Leonard:

I am writing to express my concern regarding the "discussion options" which the Committee on Ways and Means is considering related to the unrelated business income tax (UBIT). Proposed changes which would affect the substantially related standard, the convenience exception, travel and tour services offered by nonprofits, and gift shop and bookstore sales would have an adverse impact on the nation's cultural agencies. The Victoria Society of Maine is representative of the many small historical agencies in this country with operating budgets of approximately $100,000 or less. The Society operates Victoria Mansion (Morse-Libby House) as a historic house museum in Portland, Maine. The building is one of the outstanding examples of Victorian architecture to survive in the United States. I believe that changes being considered related to the UBIT would have a negative impact on the financial health of both the Victoria Society and small historical agencies like it.

The costs of preserving an important historic site are immense. Funds spent on restoration regularly exceed money in the general operating budget for the Society within a fiscal year. The Society's statement of purpose, however, mandates that the organization do more than preserve Victoria Mansion. We are charged with interpreting the Mansion and its era to the public. The Society offers exhibitions, educational programs, tours to other museums and historic sites, and books and other items related to its statement of purpose. Admissions and sales help cover operating expenses. In the fiscal year just completed, for example, sales totaled $5,500, an increase of about $3,000 from the year before. This may not appear to be a large amount compared to sales in large museum shops, but small increases in revenue have a significant impact on an organization like ours. Conversely, what might be considered relatively small increases in expenses have a significant detrimental effect. Sales of books and other materials and tours provided for our members to historic sites help fulfill the Society's function as an educational institution. To carry out that function, funds are needed. Proposed changes related to the UBIT will reduce the Society's ability to raise funds and thus have an adverse impact on its educational function.

Sincerely,

Harriet Lutes

Harriet Lutes
Board President

[Identical letter received from Glenn Uminowicz, Exec. Dir.]

VITERBO
COLLEGE

815 South 9th Street
La Crosse, Wisconsin 54601
(608) 784-0040

April 13, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

I have just learned of the House Ways and Means Sub-Committee on Oversight deliberations concerning legislative action on Unrelated Business Income Tax (UBIT). Please vote against the options which change the taxability of income producing activities of nonprofit organizations, especially those relating to program advertising revenue and facility rentals.

I am Director of the Fine Arts Center at Viterbo College, a small, liberal arts college in western Wisconsin. The College is committed to enhancing the educational experiences of its students and providing them, and regional residents, with exceptional artistic opportunities by presenting professional, national and international, fine and performing artists and companies in its Fine Arts Center.

In order to present our visiting artist program, the Fine Arts Center must rely on four major support areas: (1) program advertising sales, (2) facility rentals, (3) grants, and (4) the college budget, which is primarily generated by student tuition. Revenues generated from advertisement sales and external rentals are not large (approximately $50,000 for both areas). However, they provide important support for our programs. The options being discussed would erode revenues generated to support the artist series and transfer additional financial burden to the students through the college base budget support.

Please vote against any changes in the ABBOTT because they will have a negative impact on this organization and others like it.

Sincerely,

Thomas Reinert

Dr. Thomas Reinert
Director, Fine Arts Center

VHA.

Voluntary Hospitals of America, Inc.

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202/822-9750

Office of Public Policy

March 30, 1988

APR 04 1988

The Honorable J.J. Pickle
Chairman, Ways and Means
Oversight Subcommittee
1105 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Chairman:

We understand the Ways and Means Oversight Subcommittee is preparing its report on the tax law pertaining to exempt organizations. VHA would like to go on record against two proposals presently being considered as being against well-established national health policy and not serving any useful tax policy purpose. First, the definition of "patient" for purposes of the "convenience" exemption to unrelated business income should not exclude outpatients. Second, the sale of durable medical equipment by a hospital should remain tax exempt where "substantially related" to a hospital's exempt purposes.

There is no justifiable policy reason for limiting the definition of "patient" for purposes of the exemption to unrelated business income for the convenience of patients, students and members. It has been a long-standing national policy to encourage the use of more hospital outpatient facilities as a less expensive method of delivering medical services to patients. Hospitals are responsible for all patients whether they are being treated in a bed or on an ambulatory basis. Any change in the definition of "patient" would result in higher costs to the Federal government and contradict federal health policy objectives.

Additionally, the equating of outpatients and nonpatients is not justified. The performing of laboratory tests on nonpatients is presently subject to the unrelated business income tax so no change in the current law is necessary. It is present IRS position that the term "patients" can include outpatients as well as inpatients and in light of the above, there is no sound policy reason to change this definition.

The recommendation that income generated from the sale or lease of durable medical equipment off the hospital premises creates a presumption of unrelated business income is not warranted. Present tax law focuses on whether the hospital furnishes the type of medical treatment requiring use of the specific medical equipment in question. Thus, if the provision of durable medical equipment is an essential element of a hospital's delivery of medical care, the sale of such equipment is not unrelated business income. The fact that private concerns may also sell durable medical equipment should not be a controlling factor.

The above-mentioned proposals neither clarify federal policy nor make equitable or necessary changes.

Before taking any legislative action, we urge the Subcommittee to review the results of the Treasury audits on tax exempt entitites currently underway. Thank you for your consideration.

Sincerely yours,

Daniel P. Bourque
Corporate Senior Vice President

Congressman J.J. Pickle
Chairman, Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives
242 Cannon House Office Building
Washington D.C. 20515

Re: Unrelated Business Income Tax:
Response to Discussion Options

Dear Mr. Chairman:

We appreciate the opportunity to comment on the discussion options relating to the unrelated business income tax and released by the Subcommittee March 31, 1988. They make clear that the Subcommittee is indeed entertaining sweeping changes to the unrelated business income tax for the not-for-profit sector and the importance of hearing from that sector cannot be overstated. Our comments come on behalf of the trustees of not-for-profit hospitals and the communities we serve across the country.

SUMMARY

For the not-for-profit hospital community the options taken in the aggregate promise dramatic changes for the sector and reversals of long-accepted and socially beneficial behavior. It is in many respects shocking to learn that Subcommittee is so willing to consider changes in the nation's tax laws to meet the complaints of the small business community without apparent regard to the effects of such changes on the total structure of the voluntary sector. This sector, in which many still believe-- and we are among them-- contributes positively in infinite ways to the social fabric of the nation. This includes assuring the medical, cultural, educational and social well-being of our citizens.

Shift in Presumption that Income is Tax-exempt

For hospitals, these options effectively change the presumption that income to the 501(c)(3) organization is tax-exempt; only income which has been predetermined on an item-by-item basis by regulation would remain exempt. The options spell out what would and would not be taxable regarding:

**patient income (inpatients, "continuous care outpatients" and emergency care only and some presurgical patients),

**other operating income from within and outside the parent organization based on "each activity's" "inherent" commerciality or qualifications as a tax-exempt activity,

**passive income (royalty income traditionally exempt would now be taxable, as would income from subsidiaries created to generate passive income) and,

**philanthropy ("inherently commercial" fund-raising activities would be taxable as would those determined to be trade or business by a yet-to-be-determined rule; once-a-year galas would not be).

Artificial Definition of Hospital Patient

In addition, the options would restrict the definition of hospital patient at a time when social, medical, political and financial pressures all dictate otherwise. The medical community has succeeded over the last ten years in getting the patient out of bed and out of the inpatient setting. Hospitals have striven successfully to set up alternative treatment modalities (from in-and-out surgeries to home monitoring to ambulatory care) which are less costly, more comfortable, and with less chance of exacerbated illness or infection, for the good of the patient. Should we now say that because patients are no longer confined to beds they are no longer hospital patients?

The distinction between patient and non-patient, which is the distinction of choice, is made in current law and has been amply and ably defined in both administrative and judicial rulings over a decade. Absent data that indicates that this is being abused, and given a new commitment on the part of the IRS to enforce current rules, it seems unreasonable to create a new body of legal language at this time.

The results of changes such as these in tax law would surely satisfy the small business community. But, by building these options into the UBIT structure of the voluntary sector, we will in fact cripple it. Small business will effectively out-compete the sector and we can applaud what we have done in saving small business. It is grim reaping.

Options Regarding the Substantially Related Standard

It is difficult to understand what changes the Subcommittee feels would enhance the workability of this standard. "Directly related" is without definition but one presumes that it "tightens" relatedness. With the phrases "inherently commercial" and "determine whether each income-producing activity alone is tax-exempt" there is a clear implication of an item-by-item determination of purpose. For a currently over-burdened IRS this promises to create a remarkable new burden and falls far afield from a concept that recognizes the work and mission of a charitable organization and then examines those activities which extend and support it.

If "inherently commercial" is intended to mean that the test is whether an activity competes with the small business community then surely everything is inherently commercial. If it means rather that it can be sustained in the marketplace absent tax-exemption, then it represents a misunderstanding of the fact that it is the aggregation of services that attest to hospital purpose. Every not-for-profit institution must have activities that produce income, even a surplus of income, if the institution is to sustain as well activities that produce little or no income. This "cost-shift" assures the continued presence and availability of services that are not self-sustaining like tertiary care in hospitals, and AIDS and teenage pregnancy screening in outpatient clinics and a myriad other high cost, non-profitable services we all value and use daily in our communities.

Secondly, this test of inherently commercial disregards the ease with which some businesses may thrive as a single line of business- hearing aids for example- but be dependent on huge mark-ups and controlled competition to do it. At your own hearings you heard the testimony of the hearing aid lobby inform you that the hospitals competing with it were underselling the small business 350% mark up. We should not lose sight of the good that accrues to patients from the small business community having competition.

We agree with the Department of the Treasury that the relatedness standard is an effective and beneficial one. It allows voluntary organizations to enhance their community service in line with their mission of community service, while assuring a standard that, enforced by the IRS, does not encroach beyond that mission.

The options proposed would tax sale and rental income from medical equipment, pharmaceutical, laboratory testing for non-patients of the hospital. This is a reiteration of current law which with hospitals are complying. However, as with the proposal to tax all routine testing that is not "pre-surgical medical testing" it raises once again the question of who is or is not a hospital patient.
The routine testing proposal states that only the surgical patient-- the one whose tests come back positive-- is a legitimate patient of the hospital. What of the head injury that requires x-ray and twenty-four hours observation? The Medicaid recipient tested for pregnancy is not, nor the walk-in patient screened for AIDS. What is gained by determining on an item-by-item basis which patients are in fact the province of the not-for-profit hospital? To create a scenario where medicaid income for outpatient services is taxable is to demonstrate the difficulty of redefining patient under the presumption that income associated with patient care is taxable rather that tax exempt.

Repeal of Convenience Exception

It is unclear what would be accomplished by the repeal of the convenience exception. Certainly it would require increased item-by-item review by the IRS of activities carried on by not-for-profit hospitals for relatedness although it is difficult to understand to what end. What the convenience exception currently offers is a way to encourage employees and members (e.g. doctors) of the hospital community to work, eat and in some cases live on or near the hospital campus. This, coupled with the more obvious services to patients and their visitors, has always been regarded as a good things, something that increases the effectiveness of the not-for-profit institution in terms of response time, access and availability. In recommending the repeal of the convenience exception, which seems questionable from a conceptual point of view, the Subcommittee should keep in mind the burden it creates for the IRS as well as what it may compromise in beneficial community services provided by not-for-profit hospitals.

Allocation Rules and Taxation of Subsidiaries and Joint Ventures

The Subcommittee options clearly identify allocation rules as an area that requires "fixing," although the rationale is not apparent. With regard to both advertising and facility rentals for unrelated purposes the options severely curtail allowable deductions against expenses for the purposes of determining UBIT. This would create a far more punitive UBIT process than exists under corporate business income taxation. If the purpose was to "level the playing field" for small business, the effect instead will be to tilt it well in the opposite direction.

The option regarding for-profit subsidiaries that would have to pay taxes that are no less than the UBIT would have been had the activity been retained in the parent organization exemplifies the problem. The Subcommittee would first prejudice the UBIT process by minimizing deductions and maximizing tax liability and then assures that any activity set up to adhere to business principles-- including the payment of income taxes--- would be taxed at a UBIT rate.

It is likely that this provision would not seriously curtail hospital revenues since the vast majority of subsidiary activity is related to the primary purpose of the parent and carried on in a subsidiary for reasons of efficiency. However, the provision creates a pronounced prejudice against not-for-profits' payment of taxes in tax law and is difficult to understand from a conceptual view of fairness.

Finally, we are strongly opposed to the proposal to aggregate the income and activity of subsidiaries for purposes of testing primary purpose of the parent. It is grossly inconsistent with existing tax laws and regulations, legal guidelines and accounting principles. If the Subcommittee perceives (having repeatedly alluded to the lack of data) that this use of subsidiaries is being abused then it should be resolved as the tax accounting issue which it clearly is.

Subsidiary activity need not be regarded as suspect behavior-- which this option implies. In fact, the creation of subsidiaries is often defended as the appropriate streamlining and directing of management and other resources into defined, efficient corporations, which are frequently tax-paying corporations.

Health and Fitness Programs

The broad-sweeping proposal to tax health and fitness programs that do not have prescribed structures for community participation may or may not have been meant to include hospital programs. These run the gamut from sports medicine clinics to diet clinics to pre-birth exercise classes, from aerobics to nutrition classes for pregnant teenagers. Clarification here to protect those programs and the desireablilty of the community hospital continuing to offer them is necessary.

Fund Raising and Philanthropy

The Subcommittee options regarding fund-raising activities raise the specter once again of item-by-item determination of tax exempt status. Use of such phrases as "inherently commercial" as applied to low-cost items and distinctions between what is and is not a trade or business may require multiple new definitions. Here the options suggest that fund-raising activities produce taxable income unless they are run by volunteers and offer only donated properties. It is hard to imagine that these provisions are aimed at fundraising activities of hospitals and like institutions, but if they are not, language must make such exceptions clear.

Thank you for the opportunity to respond to these options. While we believe that the response time has been too short to fully assess the far-reaching nature of these options, we are grateful to note your decision to hold a new set of hearings and look forward to the opportunity to comment further in that setting. For questions please contact Linda B. Miller (202) 659-0338.

WASHINGTON HEARING AID CENTER
MELBOURNE TOWER, SUITE 421
1511 THIRD AVENUE, SEATTLE, WASHINGTON 98101
PHONE: 682-3185
"Hearing Health Care Professionals"

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington D.C. 20515

RE: Unrelated Business Income Tax

Dear Mr. Leonard:

Along with my husband, John, I own and operate a private, for-profit hearing aid practice in Seattle, Washington. Additionally, I am President-Elect of the National Hearing Aid Society, a professional association of some 4,000 hearing aid specialists nationwide.

In my capacity as President-Elect of the National Hearing Aid Society, I was priviledged to testify before the Oversight Subcommittee and wish to thank the Subcommittee for consideration of my testimony as evidenced by 'Discussion Option' I.B.

Having reviewed all 'discussion options', may I first commend the Subcommittee for their thoughtful, forthright study of this issue.

I strongly encourage the Subcommittee to advance legislation which applies U.B.I.T. to all hearing aid sales as well as other inherently commercial activities.

I appreciate the opportunity provided by the Subcommittee to participate in this process and stand ready to supply any further information you may desire.

In closing, once again, thank you very kindly for the sincere interest the Subcommittee has demonstrated in our plight.

Respectfully Yours,

Robin L Holm

Robin L. Holm

CC: The Honorable J.J. Pickle
U.S. House of Representatives
Washington D.C. 20515

The Honorable Rod Chandler
U.S. House of Representatives
Washington D.C. 20515

SERVING THE HEARING IMPAIRED SINCE 1953

COUNTY OF WAUKESHA

WAUKESHA COUNTY MUSEUM
JEAN PENN LOERKE
County Historian
Museum Director

COURT HOUSE ANNEX
101 West Main Street
Phone: 414-548-7186

WAUKESHA, WISCONSIN
53186

April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
US House of Representatives
1102 Longworth House Office Bldg.
Washington, DC, 20515

Dear Mr. Leonard:

I address my concerns to the proposals for changing the unrelated business income tax for exempt organizations, especially those relating to the "substantially related standard."

Our museum store is operated by the local historical society and used for museum purposes. The person in charge of buying, pricing, books, etc., is a volunteer whose duties are already time-consuming. To attempt to separate items as outlined in IA of press release 16 from JJ Pickle would make these duties much more cumbersome, and in fact, we might even have trouble keeping a volunteer in this post.

Our store is small in scope and volume of sales, yet it furnishes needed funds to augment our regular budget. On the matter of mail-order sales, although we do not sell most items via mail order, some publications which we publish are ordered by those from outside the area, and we do not feel we should have to pay taxes because we accommodate those who cannot visit the area. The mail orders generally consist of two types:

1. from those who formerly lived in the area and have continuing interest in it, and
2. from those who will be visiting the area and want to have information on our collections and research resources in the area in advance of their visit.

We trust the committee will realize how detrimental changes would be and leave this aspect the way it is. Thank you.

Sincerely,
Jean Penn Loerke
Jean Penn Loerke
Director of the Museum

Accredited by the American Association of Museums

WB&E
AUDIO & VISUAL COMMUNICATIONS
O.H.HIRT
(215) 923-1800
922 Callowhill St.
Phila., PA 19123

April 13, 1988

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

This letter is a response to Mr. Pickle's request for comments from the public regarding the unrelated business income tax. Chairman Pickle, Representative Schulze and the entire Subcommittee on Oversight are to be commended for presenting an excellent group of discussion options.

After reading press release #16 my recommendations are:

The substantially related test should be repealed and replaced by a "directly related" test.

The "regularly carried on" test should be replaced.

Apply UBIT to royalties however measured.

Increase the UBIT deduction for certain Section 501 (c) organizations to $10,000.00 with phase out completely over $50,000 income level.

Allocation Rules: adopt proposal

Expand Form 990-T reporting requirement to include more reporting on activities and income claimed to be exempt or excluded from UBIT and all revenue sources.

Recommend IRS have an integrated examination program for exempt organizations and subsidiaries. Also, recommend IRS conduct all studies listed.

We who are small businessmen find ourselves in a difficult position in this issue. The changes in UBIT we request are necessary to compel nonprofit organizations to compete fairly against us. Yet we are criticized as attacking "good works" and charitable activities.

How is it the non-profits can afford expensive lobbyists to represent them while we are confined to using a few small associations for leadership. In this situation the nonprofits are giants compared to us the small businesses. We need the help of the United States Congress.

Sincerely,

Sydney G. Willson
President

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April 14, 1988

Robert J. Leonard, Esq.
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Discussion Options Relating to the
Unrelated Business Income Tax

Dear Mr. Leonard:

Under date of March 31, 1988, Congressman Pickle, Chairman of the Subcommittee on Oversight, Committee on Ways and Means, issued Press Release No. 16 concerning the Subcommittee's preliminary discussion options regarding the unrelated business income tax (UBIT) and solicited public comments on the discussion options. On behalf of several of our clients (including 501(c)(6) trade associations and 501(c)(3) professional organizations), we submit the following comments in regard to the tax treatment of income received by tax-exempt organizations in connection with the conduct of "qualified trade show and convention activities."

In Section X of the Subcommittee's discussion options, one of the options set forth is the consideration of "modification of various piecemeal UBIT exclusions enacted since 1969." Presumably, one such exclusion to be considered is that set forth in Section 513(d) of the Internal Revenue Code. That subsection initially was enacted as part of the Tax Reform Act of 1976 and specifically excluded from the definition of "unrelated trade or business" all "qualified convention and trade show activities" of any 501(c)(5) and 501(c)(6) organization that "regularly conducts as one of its substantial exempt purposes a show which stimulates interest in, and demand for, the products of a particular industry or segment of such industry." Public Law 94-455, Section 1305.

In the Tax Reform Act of 1986, Section 513(d) of the Internal Revenue Code was amended to make it clear that the "qualified trade show and convention activities" that would be exempt from treatment as an "unrelated trade or business" included such activities carried on by any 501(c)(3) or 501(c)(4) organization that "regularly conducts as one of its substantial exempt purposes a show which stimulates interest in, and demand for, the products of a particular industry or segment of such industry or which educates persons in attendance regarding new developments or products and services related to the exempt activities of the organization." IRC §513(d)(3).

Thus, under persent law, "qualified trade show and convention activities" of 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) organizations are specifically exempted from the definition of "unrelated trade or business" and the income derived from those activities is not subject to the unrelated business income tax (UBIT).

Given the extensive consideration that Congress devoted to the issue of the taxability (under UBIT) of convention and trade show income in 1976 and the recent (Tax Reform Act of 1986) expansion of the types of organizations that are recognized as not generating unrelated trade or business income by the conduct of convention and trade show activities, there is no reason for the Congress (or the Subcommittee on Oversight or the Committee on Ways and Means) to revisit this issue now. Moreover, the legislative history of the evolution of IRC §513(d), and its amendment in 1986, demonstrates the conviction of Congress that trade show and convention activities clearly are related to the exempt purposes of 501(c)(3), (4), (5) and (6) organizations and, therefore, that the income received from those activities should not be subject to taxation under UBIT principles.

The legislative history of the 1976 amendment to the Internal Revenue Code, which added §513(d) to the Code, demonstrates that Congress was convinced: 1) that trade show and convention activities of tax-exempt organizations do not represent the "commercial" exploitation of such organizations' exempt status in order to "unfairly compete" with business or profit-making entities; and 2) that trade show and convention activities are intimately and substantially connected to the carrying out of their exempt purposes by tax-exempt organizations.

In its report, recommending that trade show and convention income be exempted from the unrelated business income tax, the Senate Committee on Finance recognized that UBIT was intended to extend to activities of tax-exempt organizations that were not "related" to the exempt purposes of the organizations. It further recognized that a "major purpose" of the UBIT provisions "is to make certain that an exempt organization does not commercially exploit its exempt status for the purpose of unfairly competing with taxpaying organizations." The Committee determined, however, that trade show and convention activities of tax-exempt organizations are "related" to exempt purposes and do not constitute unfair competition with profit-making entities:

> It has come to the committee's attention that, in two instances, the Internal Revenue Service has ruled that activities which are not conducted in competition with commercial activities of taxpaying organizations are nevertheless considered to be unrelated trade or business activities which are subject to the unrelated business income tax. In one case (Rev. Rul. 68-505, 1968-2 C.B. 248), the Service ruled that an exempt county fair association which conducts a horse racing meet with parimutuel betting is carrying on an unrelated trade or business subject to the unrelated business income tax. In another case the Service has held, in a series of revenue rulings (TIR-1409, 1975-2 C.B. 220-226), that income that an exempt business league receives at its convention trade show from renting display space may constitute unrelated business taxable income if selling by the exhibitor is permitted or tolerated at the show.
>
> The committee does not believe that the activities dealt with in those rulings are generally unrelated to the exempt purposes of the organizations that conduct them. It is customary for tax-exempt organizations to provide entertainment, incuuding [sic] horse racing, at fairs and expositions in order to attract the public to the educational exhibits on display. In addition, trade associations use trade shows as a means of promoting and stimulating an interest in, and demand for, their industries' products in general. They are also able to educate their members regarding new developments and techniques which are available to the trade.

> In neither case are the exempt organizations exploiting their exempt status in order to compete unfairly with taxpaying organizations. Generally, horse racing dates are controlled by state authorities and are made available on a state-wide basis to only one organization for any one period. Trade shows are generally conducted only by trade associations and not by taxpaying entities.

Senate Report No. 94-938 at Page 602.

In the Tax Reform Act of 1986, IRC §513(d) was amended to cure two deficiencies in the 1976 legislation. The 1976 legislation had been intended to extend the tax-exempt treatment of trade show and convention income to 501(c)(3) and 501(c)(4) organizations as well as 501(c)(5) and 501(c)(6) organizations. The 1976 legislation, however, was passed in order to correct the Internal Revenue Service's erroneous interpretations of the law as set forth in Revenue Rulings 75-516 through 75-520, 1975-2 C.B. 220-27. Those rulings had only addressed trade show and convention activities of 501(c)(5) and 501(c)(6) organizations and, therefore, only those types of organizations were specifically identified in the 1976 legislation. Subsequent to passage of the 1976 legislation, it became apparent that the IRS intended to utilize the erroneous 1975 revenue rulings in analyzing the taxability of trade show and convention income of all other 501(c) organizations. Congress rejected the IRS position by adding 501(c)(3) and 501(c)(4) organizations to those specifically identified in IRC §513(d).

The 1986 amendment also made it clear, by statute, that so-called "supplier" shows at which suppliers engaged in sales activity or order-taking were "qualifying" shows, did not constitute the conduct of an unrelated trade or business, and were not subject to taxation.

Thus, as recently as 1986, Congress has recognized that: 1) trade show and convention activities traditionally have been sponsored by tax-exempt organizations; 2) trade shows and conventions are substantially related to the exempt purposes and functions of tax-exempt organizations; 3) the conduct of trade shows and conventions, sponsored by tax-exempt organizations, does not represent the commercial exploitation of such an organizations' exempt status for the purpose of unfairly competing with taxpaying organizations; and 4) the income derived from the conduct of trade show and convention activities is not the type of income that is intended to be covered by the unrelated business income tax.

The organization and operation of trade shows and conventions is one of the most important functions performed by a professional society or a trade association. In the context of trade associations, trade shows and conventions are directly related to exempt purposes because they serve to further the common business interests of the association's members by providing an opportunity for the members of a particular industry to display their products to the public and potential purchasers. In the context of professional societies, trade shows and conventions are directly related to exempt purposes because they contribute directly to the development and dissemination of educational and scientific information; such shows and conventions, invariably, are conducted in conjunction with scientific and educational symposia and seminars.

It is for these reasons, and the fact that trade shows and conventions of tax-exempt organizations are non-commercial activities that, by their very nature, do not unfairly compete with the activities of taxpaying organizations, that Congress inserted section 513(d) into the Internal Revenue Code. Simply put, the trade show and convention activities of tax-exempt organizations do not constitute the conduct of an "unrelated trade or business" and are not subject to taxation.

That is precisely what IRC §513(d) presently provides and we strongly urge the members of the Subcommittee on Oversight and the Committee on Ways and Means to retain that provision as it exists under current law.

Respectfully submitted
WEBSTER, CHAMBERLAIN & BEAN

By: Frank M Northam
Frank M. Northam

Wenham Historical Association and Museum, Inc.

132 MAIN STREET
WENHAM, MASSACHUSETTS 01984
(617) 468-2377

ELEANOR E. THOMPSON
DIRECTOR

April 12, 1988

Mr. Robert J. Leonard
Chief Counsel
Commission on Ways and Means
U.S. House of Representatives
1102 Longworthy House Office Building
Washington, D.C. 20515

Dear Mr. Leonard;

I am writing to protest the proposed tax changes which will affect the museums in our country. The income which museums, small and large, receive from their shops and other "unrelated business" are vital parts of operating budgets. Our museum received about eight percent of total operating funds from the running of our small gift shop in 1987. We would be extremely hard pressed to earn this amount of money in other ways as we are already raising over twenty percent of our budget through special events and fund raising activities.

Please reconsider and vote to support culture through the museum field.

Sincerely yours,

Eleanor E. Thompson
Director

WESTAF

April 14, 1988

A regional
affiliation
of the
state arts
agencies of:
Alaska
Arizona
California
Colorado
Hawaii
Idaho
Montana
Nevada
New Mexico
Oregon
Utah
Washington
Wyoming

The Honorable J. J. Pickle
242 Cannon House Office Building
Washington DC 20515

Dear Congressman Pickle:

I am writing to you to express the deep and urgent opposition of the Western States Arts Federation (WESTAF) to the new proposal from the House Ways and Means Committee to tax income-producing activities of non-profit organizations.

WESTAF is a regional organization providing programs in the performing, visual and literary arts for the 13 states of the West: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming. The purpose of the organization is to provide leadership and support for the arts of the region, and its general goals are to 1) support excellence in, cultural diversity of, and access to the arts; 2) offer opportunities, programs and services in the arts; 3) provide forums for the arts regionally, nationally and internationally; and 4) advocate the arts to the public and private sectors. On these grounds, the present letter is an expression of the opposition of the entire arts community in our vast region (artists, arts agencies and organizations, and audiences) to the options concerning Unrelated Business Income Tax recently announced by the Subcommittee on Oversight.

Without going into the specifics of the Subcommittee's options, I can state categorically that the impact of these "suggestions", if they are implemented, on the non-profit arts world would be catastrophic. For at least the past fifteen years the arts have been seriously attempting to lessen their demand on public and private support by developing avenues of "substantially related" earned revenues; the options proposed by the Subcommittee could essentially destroy that possibility for many arts organizations and render them once again entirely dependent upon civic and personal generosity. Beyond that, some of the options would severely handicap efforts of the arts even to secure traditional private donations which have been their mainstay.

It is understood that the proposed changes are a result of pressures from the for-profit sector to limit "unfair competition". However, it should be pointed out that these changes in Unrelated Business Income Tax could serve to intensify that competition. Organizations with well-developed earned income mechanisms would frequently continue those activities, while being forced to increase their efforts substantially in order simply to hold after-tax profits at the previous levels of income. In addition, if business activities should be taxed in any event, many non-profit organizations might also enter other completely unrelated commercial arenas, not only increasing, but broadening the perceived competition with the for-profit sector.

From both of the above points of view, the Subcommittee's options would be unproductive at best and disastrous at worst. Their implementation could on the one hand negate the progress made by non-profit organizations in achieving a greater degree of self-sufficiency, and on the other, simply exacerbate the problem the options were intended to address.

Though this letter does not address the details of the individual proposed options, I trust that the general philosophical objections raised above are clear, and hope that the Subcommittee will fully consider the honest and adamant opposition of the arts in the West to proposals which could crucially effect their survival.

Sincerely,

Terry R. Melton
Executive Director

TRM:rjb

c: Independent Sector
National Assembly of State Arts Agencies
National Assembly of Local Arts Agencies
American Arts Alliance
Executive Committee, WESTAF
Hon. Pete V. Domenici
Hon. Jeff Bingaman
Hon. Manuel Lujan, Jr.
Hon. Joe Skeen
Hon. Bill Richardson
Hon. Pete Stark
Hon. Robert Matsui
Hon. William Thomas
Hon. Hank Brown
Hon. Rod Chandler

Whatcom
Museum of History & Art

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

RE: Options Relating to Unrelated Business Income Taxes

Just when museums and cultural non-profit organizations are having to deal with diminished contributions resulting from reduced tax incentives contained in the 1986 Tax Reform Act, they now must face the potential of the impact of major changes to the laws relating to unrelated business income taxes. The options now under review, if inacted, will actively discourage efforts of small non-profits to develop alternate revenue sources.

In light of current planning to stablize the Whatcom Museum's revenue several proposed UBIT options seem especially restrictive. In particular is the option for "off-premise" sales of substantially related items to be taxed exactly the same as sales of completely unrelated items. If this option is intiated we would face revenue reduced by the amount of taxes or the question of eliminating taxable revenue so as not to risk non-profit status.

Repeal of the exception for income from activities carried on for the convenience of museum members (such as gallery and art studio tours) would result in increased costs to members or the elimination of activities which produce taxable revenue.

In most cases of museums and cultural institutions the revenue producing shops, off-premise sales or "convenience" services represent non-competitive propriety or sole source items. To the extent that they support charitable services and do not directly or indirectly compete with small business, they should be encouraged rather than discouraged or eliminated.

Sincerely,

George E. Thomas
Director

121 Prospect Street, Bellingham, Washington 98225 Phone: (206)676-6981

WILLIAMS COLLEGE MUSEUM OF ART
WILLIAMSTOWN · MASSACHUSETTS · 01267
TELEPHONE · (413) · 597 · 2429

April 11, 1988

Robert J. Leonard
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

This letter is in response to the call by the Oversight Subcommittee of the House Ways and Means Committee for public comment on the issue of taxation of nonprofits' revenue-producing activities. It is my sincere hope that this letter is of some assistance in your discussion process.

The Museum Shop at the Williams College Museum of Art, like many other shops in museums across America, provides an extremely valuable form of earned income for our programs and operations. Our museum, also like many others, does not charge admission to the public. We do this for a variety of reasons: 1) as a college museum we provide our services free to students, and 2) we also want to make our exhibitions and programs accessible to the widest possible cross section of our regional public. Without museum shop income we would have to curtail many of our most public programs since the first priority of this institution is to serve the students of Williams College. However, our annual attendance (just over 100,000) demonstrates that we serve a much wider public than the 2,000 students and 500 faculty/staff members at Williams College. In addition, our special exhibition programs are very expensive and are becoming more expensive in light of inflation and it would be very difficult to present these programs without the income provided by our museum shop.

In addition to being the assistant director at the Williams College Museum of Art, I am also the New England representative for the Association of College and University Museums, a national organization with affiliate status with American Association of Museums. I therefore speak for a number of college museums in New England when I say that it is unfair and inconsonant to levy taxes against arts organizations who already have very few earned income opportunitiesto fund their nonprofit, public serving programs.

Thank you very much for considering the concerns stated in this letter. I assume that you will hear many similar concerns from the entire community of museum and arts organizations across America.

Sincerely,

W. Rod Faulds
Assistant Director

Wisconsin Alliance of Hearing Professionals

30 WEST MIFFLIN STREET
MADISON, WISCONSIN 53703
PHONE: 608/257-3541

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April 13, 1988

Mr. Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Leonard:

Attached please find comments concerning discussion options regarding reform of the Unrelated Business Income Tax (UBIT) system that applies to nonprofit organizations. The attachment to this letter, which we hereby submit, was distributed at the Wisconsin Small Business Conference held here in November 1987. Unfair competition from nonprofits was ranked among the top 10 issues of concern to small business. We are especially concerned that the discussion options focus upon the inherent commercial nature of hearing aid sales. The current "convenience" exemption for patients should be repealed or patients should be recognized as inpatients only.

We are finding that nonprofit hospitals and clinics are entering the hearing aid dispensing market, selling aids at costs low enough to drive out for profit aid sellers and then increasing aid prices. This kind of cut throat predatory pricing will ultimately be self-defeating to the taxpayers and hearing impaired.

We commend the Oversight Subcommittee for its final UBIT recommendations. It is an excellent package of reform measures and they should all be included in the committees final report.

Thank you for accepting our written testimony.

Respectfully yours,

Douglas Q. Johnson, Esq.
Executive Secretary

cc: Alliance Board Members

Wisconsin Alliance of Hearing Professionals is a division of the Wisconsin Merchants Federation.

#38794

DOES YOUR COMPETITION PAY TAXES?

Non-profit competition was identified as the #3 issue by the 1986 White House Conference on Small Business. Only liability insurance and mandated benefits ranked higher. Tax exempt institutions intrusion into for profit business markets is big business with annual revenues of more than 300 billion dollars or 8 per cent of the Gross National Product. The unfair advantages enjoyed by non-profit competitors who abuse their tax-exempt status impacts upon many small businesses.

Unfair aspects include:

1.) The nonprofit may pay no federal, state or local income taxes on profits generated from sales of products and services.

2.) The nonprofit may be exempt from other taxes normally borne by most businesses such as sales tax, inventory tax and property tax.

3.) The nonprofit may use nonprofit mailing rates in its sales promotion activities.

4.) Venture capital from non-profit organizations may be used to start spin off for profit-corporations.

Fox example, more nonprofit hospitals and clinics are dispensing hearing aids, opening retail pharmacies on hospital grounds, using excess laundry capacity to do laundry for hotels and motels, advertising and opening their cafeterias to the general public. As "non-profit" business expands, more and more businesses are closing their doors.

The abuse of tax status goes beyond nonprofit hospitals and clinics. Other nonprofits are involved. Fox example, YMCA's are opening health clubs in competition with tax paying for profit health clubs. Then we have local and state governments competing with small business. The University of Wisconsin system supported by your tax dollars selling computers, hearing aids and printing services. The Small Business Administration has already identified unfair competition from non profits as a major issue facing small business in the 1980's.

The Governor's Conference on Small Business has the opportunity to follow the lead of the White House Conference on Small Business and the Small Business Administration.

If tax free, non-profit organizations are allowed to unfairly compete with private enterprise and if such actions ultimately force the tax-paying business out of business, who then will pay the taxes necessary to support our government and its programs?

Non-Profit Sector Getting Bigger Slice Of The Business Pie

By JOHN CUNNIFF
AP Business Analyst

NEW YORK (AP) — Spurred by the need to make up shortfalls in charitable contributions and grants, non-profit operations such as museums, hospitals and colleges are expanding rapidly into commercial areas, a study shows.

In the proces, says Thomas J. DiLorenzo of the Center for the Study of American Business, they are threatening the existence of many private-sector business competitors, and are cutting deeply into government tax revenue.

Although widely viewed as charities that serve the public interest, DiLorenzo contends that less than 10 percent of all non-profits so labeled by the Internal Revenue Service are actively engaged in charitable activities.

Behind the rapid expansion of the commercial non-profit sector, he says, is the need to make up for the shortfall of contributions, partly as a result of new tax law and in part because of reduced governmental subsidies.

Commercial non-profit competition with small business is endemic and expanding rapidly, he said, citing among others examples the sale of household furnishings, clothing, jewelry and toys by the Smithsonian Insitution.

According to his research paper, the Smithsonian operated 13 gift shops with revenues of more than $27 million last year, conducts tours to 18 foreign countries, operates restaurants and sells a government-subsidized magazine.

He cites examples of hospitals increasingly moving into such businesses as helicopter and taxi services, health clubs, collection agencies, interior decorating, catering, pharmacies and laundries.

"College bookstores sell everything from computers to razor blades in direct competition with local merchants ... YMCAs operate health spas in every major city in competition with private health clubs ... research and testing labs have been driven from the market by university or non-profit labs."

Overall, he estimates about $300 billion worth of commercial goods and services are provided by so-called non-profit efforts, two-thirds of which were created since 1960, and says the situation is destined to present federal policymakers, commercial businesses and municipalities with serious decisions.

Private companies are at a huge disadvantage in competing with commercial non-profit enterprises, he says in the paper, one of a continuing series on contemporary issues by the center, part of Washington University in St. Louis.

DiLorenzo, a visting professor at the center on leave from George Mason University, observes that such enterprises pay no federal, state or local property, sales or income taxes, and are given government grants and contracts.

Among other advantages they enjoy, he points out, they may solicit tax-deductible contributions and use volunteer labor, pay lower postal rates, remain exempt from regulations that impose enormous costs on private firms and receive special treatment regarding unemployment insurance, minimum wages, securities regulation, bankruptcy, antitrust regulation and copyright laws.

Ironically, he says, "private businesses are being taxed so that part of that revenue can be used to subsidize their 'non-profit' competitors."

Such competition, he says, not only crowds out small businesses that have proven to be innovators and job creators, but replaces them "with some of the most inefficient and bureaucratic."

He argues that since most commercial non-profit enterprises are in the service sector, the increase in their activities may worsen the problem of slow productivity growth, which in turn could mean lower wages and higher prices.

In concluding the paper, DiLorenzo states: "The problem is not non-profit competititon per se, but unfair competition. There is no good reason why governmental policy should favor one commercial enterprise over another."

He suggests that if non-profits enter business for a profit they should do so through a subsidiary that is subject to "all the rules and regulations that all for-profit business are required to obey."

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Certified Hearing Aid Audiologist
Board Certified (NBC-HIS)

Authorized Dealer for Beltone Hearing
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April 9, 1988

Robert J. Leonard, Chief Counsel
Ways and Means Committee
US House of Representatives
Longworth House Office Building, Room 1102
Washington, D.C. 20515

RE: Options regarding Reform of the Unrelated
Business Income Tax System

Dear Mr. Leonard:

I am enclosing a copy of my original letter to you of June 10, 1987 along with its attachments. I am also attaching more recent correspondence with Federal and State of Wisconsin officials.

As you will notice, our State of Wisconsin government officials are very much aware of the problem of non-profit competition and are waiting to piggyback and incorporate any changes in the Federal Tax Code into the Wisconsin Revenue Code. They realize that taxing Unrelated Business Income of nonprofits is an additional large State Income Tax Revenue source. Our Wisconsin Department of Revenue is waiting for direction from Washington on this issue.

I would like to commend the Honorable J.J. Pickle and his committee for their sensitivity on this issue and the excellent proposed package of reform measures. I would hope that the entire package of reform measures be passed.

As the reform package pertains to my hearing aid business, it is most important that hospitals have their "convenience exemption" repealed for patients or to recognize patients as inpatients only. Without a clear definition of the word "patient" nonprofit hospitals are advertising their hearing aid business to the general public in direct competition with taxpaying hearing aid dispensers. Hearing aid dispensers have no problem with hospitals fitting hearing aids on inpatients, but we draw the line on advertising to the general at large public. I don't think the intent of the Internal Revenue Code was all "patients", but only inpatient sales be income tax exempt. Thank you!

Sincerely,
James A. Bohren
James A. Bohren
Certified Hearing Aid Audiologist
Board Certified (NBC-HIS)

JAB:sk
enc.

Immediate Past President WI. Alliance
of Hearing Professionals

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June 10, 1987

Robert J. Leonard, Chief Counsel
Ways and Means Committee
U.S. House of Representatives
Longworth House Office Building, Room 1102
Washington, D.C. 20515

RE: Abuses of Tax Exempt Status by
Tax-exempt (Nonprofit) Organizations

Dear Mr. Leonard:

In anticipation of the hearings by the House Ways and Means Oversight Committee the week of June 22nd regarding abuses of tax exempt status, I would like to take this opportunity to make you aware of the serious nature of the problem as it relates to tax paying for-profit small business people in Wisconsin and nationally. You are most likely aware that abuses of tax exempt status was the number three concern nationally at last summer's White House Conference on Small Business.

First of all, I am not anti nonprofit organization; the Boy Scouts/Girl Scouts, Big Brothers/Big Sisters Organizations operate well under their nonprofit tax exempt status. The big offenders are the YMCA's and hospitals getting into commercial ventures that compete with for profit business. Hospitals are opening for profit pharmacies, dispensing hearing aids, using excess laundry capacity to do laundry for hotel and motels in competition with for profit laundries. These commercial activities are clearly out of the realm of activity of these nonprofit organization's origional mission when their tax exempt status was granted. Even if the nonprofit does form a for profit corporation for their commercial activities, the venture capital to start the for profit corporation is coming from the tax exempt dollars of the nonprofit corporation. If I want to expand my business, I have to borrow my venture capital from a bank or other financial institution. This situation is a very unfair advantage for the nonprofit organization. Millions of dollars of profits from these commercial ventures are not taxed.

Competition between commercial for-profit firms and tax-exempt organizations is increasing. Markets traditionally served by small, for-profit firms are now being offered products and services produced by tax-exempt, not-for-profit entities.

While the public perception of tax-exempt organizations is that they derive most of their income from charitable contributions and tax revenues, according to reports filed with the Internal Revenue Service (IRS), they derive 76 percent of their income from sales. In contrast, their gifts and dues income represents only 23 percent of their income. Of course, some of the sales may be charges for such things as publications, that are clearly part of the nonprofit's charitable, educational or cultural mission serving the needy, the sick and disabled or association members. However, the competition posed by many of these sales activities is unfair and should be dealt with.

The basic question is, "What is unfair about competition from nonprofits?" Products and services which are offered by a nonprofit in direct competition with products and services offered by a small, for-profit business provide the basis for the charge of "unfair" competition. The unfair aspects are:

1.) The nonprofit may pay no Federal, state or local taxes on profits generated from sales of products and services.
2.) The nonprofit may be tax-supported.
3.) The nonprofit may use nonprofit mailing rates in its sales promotion activities.
4.) The nonprofit may be exempt from normal taxes borne by most businesses such as sales tax, inventory tax and property tax.
5.) The nonprofit may operate using rent-free facilities and a work-force paid in part or in whole by public funds.
6.) Venture capital from non-profit organizations may be used to start spin off for-profit corporations.

What are some solutions to this problem? A few solutions would be:

Prohibit nonprofits from competing with for-profits.

Reform the IRS Code and procedures to tax profits earned by nonprofits.

Deny nonprofit tax status to those entities which compete with for-profits.

Prohibit nonprofits from using tax exempt dollars as venture capital in setting up spin off for-profit corporations.

Some specific examples of unfair competition in my area of Wisconsin by nonprofits are the following: My local YMCA has opened a health club in direct competition with local for profit health clubs. The YMCA has a child day care center in competition with local for profit child day care centers. Our local Memorial Medical Center (hospital) has opened and is advertising its cafeteria to the general public giving senior citizen discounts. This is in direct competition with local tax paying restaurants.

Plymouth Valley View Medical Center (hospital) has opened a retail pharmacy in Elkhart Lake, Wisconsin. Venture capital for startup and employee salaries coming from the nonprofit hospital. This pharmacy is in direct competition with local tax paying pharmacies.

St. Agnes Hospital in Fond du Lac, Wisconsin has been dispensing hearing aids for a number of years in direct competition with local tax paying hearing aid dispensers.

The Sheboygan, Wisconsin Rehabilitation Center as a supplement to their budget is in the recycling business in direct competition with the local tax paying recycling businesses.

Numerous hospitals in Milwaukee and Southern Wisconsin are dispensing hearing aids in direct competition with local for profit dispensers. One for profit dispenser in Kenosha, Wisconsin saw his office gross income drop from $100,218.00 to $63,565.00 from October 31, 1985 to October 31, 1986. This took place right after Kenosha Memorial Hospital started dispensing hearing aids.

As you can see Mr. Leonard, I am not whistling in the wind with my concerns; tax paying small business people throughout the nation need action by the Ways and Means Committee. I am all for competition and I have plenty, but I would like my competition to pay taxes and operate under the same ground rules I have to!

As I stated before, these commercial activities are clearly out of the realm of activity of these nonprofit organizations' origional mission when their tax exempt status was granted.

As you can see by my enclosed letters from the Lt. Governor and Revenue Secretary of Wisconsin, they are concerned about the problem and are waiting direction from Washington. Thank you for your consideration.

Sincerely,

James A. Bohren

James A. Bohren
Certified Hearing Aid Audiologist
Board Certified (NBC-HIS)

JAB:sk
enc.

CC Senator Robert W. Kasten, Jr.
Senator William Proxmire
Congressman F. James Sensenbrenner
Congressman Thomas Petri
Congressman James P. Moody
James Lovell, National Hearing Aid Society
Abe Schneier, National Federation of Independent Business

Office of Lieutenant Governor
State of Wisconsin

Scott McCallum
Lieutenant Governor

May 29, 1987

Mr. James A. Bohren
Beltone Hearing Aid Service
1933 North 8th Street
Sheboygan, WI 53081

Dear Mr. Bohren:

Thank you for the copy of your letter on abuses of tax exempt status by non-profit organizations you mailed to Governor Thompson.

Your points are thoughtful and very convincing. Closing certain tax loopholes would indeed impact favorably upon property taxes. I will keep your letter on file and discuss its points with the Govrnor.

If I can be of additional assistance, please do not hesitate to contact me.

Sincerely,

Scott McCallum

Scott McCallum
Lieutenant Governor

SM/RM/k

Room 22 East • State Capitol • Madison, WI 53702 • (608) 266-3516

ACI Auditory Centers
111 East Wisconsin Avenue
Suite 725
Milwaukee, Wisconsin 53202
(414) 273-2434

February 25, 1987

Mr. Doug Johnson
Executive Secretary
Wisconsin Alliance of Hearing Professionals
300 W. Mifflin Street
Madison, WI 53703

Dear Doug:

I want to thank you, James A. Bohran, the Wisconsin Alliance of Hearing Professionals and the Wisconsin Merchants Federation for an excellent chapter meeting. I also want to express my desire to pursue the effects of non-profit hospitals, clinics, universities and HMO's on small, private businesses.

I know that Kenosha Memorial Hospital has had a significant effect on all for profit dispensers in the Kenosha area. Sales in our ACI Auditory Centers Kenosha office dropped from $100,218 to $63,565 from October 31, 1985 to October 31, 1986. Over the past 18 months we have taken a real beating in the Kenosha marketplace.

Doug, I think you know me well enough to understand that I don't mind competition, however, I would like the non-profits that decide to buy their way into the hearing health care business to be taxed appropriately. Kenosha Memorial Hospital's program is a simple social program designed to get the hospital into the hearing aid business. They felt the quickest way was to run a discount program. After they have made a significant impact and perhaps caused a few dispensers to go out of business, they will raise their prices.

I think Governor Thompson and the IRS should be aware of the effect on small business in our state.

Sincerely yours,

Otis A. Whitcomb, M.A.
President

— Better Hearing Through Professional Care —

Tax-exempt status called too broad

Madison, Wis. —AP— The Legislature should review laws that grant a wide variety of organizations tax-exempt status, the Legislative Audit Bureau says.

The audit bureau said it found that local tax exemptions had been granted to groups as diverse as a barbershop quartet, a drum corps and a foundation providing financial aid to former golf caddies.

Clear definitions should be established for what constitutes "benevolent and educational associations."

The report said a typical Wisconsin homeowner could have saved $92 in property taxes last year if all private tax-exempt property had been taxed.

The bureau said, however, that it was unlikely that the Legislature would ever repeal exemptions, which are also granted to non-profit hospitals, labor temples and buildings owned by fraternal societies.

The bureau said the State Department of Revenue should revise its regulations to clarify that YMCA and YWCA property was exempt from taxation only to the extent that it was used for educational and religious purposes.

The bureau said local assessors had become concerned that YMCAs and YWCAs had turned from their original missions to become more like health clubs in competition with the private sector.

About 29% of all real property in Wisconsin is tax exempt, the bureau noted. Of that total, 67% is owned by federal, state and local governments, 10% is owned by religious associations and the remaining 23% is owned by private, non-profit groups.

Tommy G. Thompson
Governor
James R. Klauser
Secretary

Mailing Address:
Post Office Box 7864
Madison, WI 53707-7864

State of Wisconsin
Department of Administration

101 South Webster Street • Madison, Wisconsin

February 3, 1988

James A. Bohren, President
Wisconsin Alliance of Hearing Professionals
1933 North 8th Street
Sheboygan, WI 53081

Dear Mr. Bohren:

Thank you for your letter expressing your concerns regarding tax treatment of nonprofit organizations engaging in "for profit" businesses. I apologize for not answering sooner, but I am pleased to be able to tell you that the Governor has responded to your concerns.

The Governor's Property Tax Relief and Education Initiatives bill contains a provision that would subject the nonrelated business income of tax exempt organizations to the corporate income tax. The state tax would piggyback onto the federal tax treatment. As concern over the issue of competition between tax exempt and non exempt businesses is growing nationally, the federal government may tighten up its restrictions. The change the Governor has proposed would put Wisconsin in the position of reinforcing such restrictions through its own tax treatment.

We estimate that this provision will generate about $500,000 in state revenue annually. However, its primary purpose is to promote a "level playing field" by taking away some of the tax advantage of exempt organizations that compete with businesses. It is not clear at this point how the Legislature will react to this proposal. Given your strong feelings on the issue, you may wish to convey your stance to the Legislature in the course of its deliberations on the Governor's initiatives.

Once again, thank you for conveying your concerns. While tax exempt status for "non profit" charities is well motivated from the policy standpoint, abuses do need to be addressed. I hope you will continue to keep me informed of your views.

Sincerely,

James R Klauser

James R. Klauser
Secretary

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November 10, 1987

James R. Klauser
Secretary
State of Wisconsin
Department of Administration
101 South Webster, 7th Floor
P.O. Box 7864
Madison, Wisconsin 53707-7864

RE: Abuses of Tax Exempt Status by Nonprofit Organizations

Dear Secretary Klauser:

In followup to our conversation on Monday, November 9th, at the Legislative Reception during the Governor's Conference on Small Business and at your request, I would like to expand on the above issue.

As you may be aware, abuses of tax exempt status by nonprofits was the number three concern Nationally at the 1986 White House Conference on Small Business in Washington, D.C.. Hearings were held on the Issue in July of this year by the House Oversight Committee of Ways and Means. I expect recommendations and a hearing of the Full House Ways and Means Committee within the next year. Because of the large scale intrusion of nonprofits (mainly hospitals) into for profit business in Wisconsin, we cannot wait for Federal action. By the way, the IRS already does tax unrelated business income of nonprofits, although the IRS interpretation of unrelated income and nonprofit mission statements is far toe broad.

Let me just list some of the businesses that nonprofit hospitals are getting into in Wisconsin: Catering and vending business, printing, dry cleaning and laundry, retail pharmacy, dispensing hearing aids, retail optical departments opening, advertising employee and visitor cafeterias to the general public, professional uniform business.

As you can see from the above list, these unrelated businesses have nothing to do with the Mission Statement that was used to obtain their tax exempt status. You mentioned to me Monday night that this unrelated income was getting way out of hand and should be taxed. The hospitals should be paying sales tax on the businesses they are in that are subject to sales tax. They should be paying income tax on this unrelated income. (See my attached letter from Karen Case) She says Wisconsin presently does not tax unrelated income of nonprofits; why not? The IRS does and Wisconsin Department of Revenue usually piggybacks the IRS. We are talking millions of dollars in additional sales and income tax revenue for the State of

Wisconsin! The side benefit would be creating a level playing field for the for profit businesses who have to compete with nonprofits.

On a local basis, local property tax assessors should be taxing those departments of the hospital that are generating unrelated income. Again, Statewide millions of dollars in property tax revenue is not being assessed or collected.

In our Governor's Conference on Small Business that was completed today, the issue of nonprofit competition, issue #59 in the hand out, came in #15 in the top 40 recommendations for action. One other thing I would like to point out is that at times the nonprofit may form a for profit corporation for their unrelated business. Usually, instead of borrowing money at a bank or other loan source as I would have to if I wanted to expand my business, they use tax exempt dollars as venture capital. This should stop and is a huge competitive advantage for the nonprofit.

One highlight of the hearings in Washington, D.C. this summer on nonprofits: A California member of the House said California is looking at doing away with tax exempt status for all California hospitals and making them all for profit. Instead of the nonprofit status, they would be given a tax credit for the amount of actual charitable care given for that tax year. He said, a hospital in Palm Springs, California does not deserve to be nonprofit in a millionaire community.

Hopefully, some of this additonal tax revenue can be used for property tax relief. Thanking you in advance for your help and concern on this vital issue that affects small business in Wisconsin. Please keep me informed on your efforts and progress.

Sincerely,

James A. Bohren

James A. Bohren
Certified Hearing Aid Audiologist
Board Certified (NBC-HIS)

President
WI. Alliance of Hearing Professionals

JAB:sk
enc.

P.S. Many people complained at both lunches at the fieldhouse during the Conference that the lunches should have been catered by one of Madison's fine catering businesses rather than the University of Wisconsin!

CC State Senator William Te Winkle
State Representative Wilfrid Turba
State Representative Calvin Potter
Douglas Q. Johnson, Executive Secretary
WI. Alliance of Hearing Professionals
(Div. of WI. Merchants Federation)
Bill G. Smith, NFIB/Wisconsin

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January 28, 1988

State Senator William P. Te Winkle
State Capitol, Rm. 136 South
P.O. Box 7882
Madison, Wisconsin 53707-7882

RE: The Proposed Taxing of Unrelated Business Income of Non-Profit Organizations

Dear Senator Te Winkle:

I was extremely happy to read in the Milwaukee Sentinel yesterday that part of Governor Thompson's Property Tax Relief Program was taxing the unrelated business income of non-profit organizations. I am most grateful to Governor Thompson, Secretary James Klauser and to Revenue Secretary Karen Case for their sensitivity on this issue that affects many small businesses in Wisconsin. I would also like to thank you for your efforts on my behalf.

This issue, as it relates to my business, needs a bit of clarification and being aware that you are Chairperson of the Tax Exemptions Committee, perhaps you can be of help.

Tax exempt hospitals throughout Wisconsin have been dispensing hearing aids and not paying any State Income Tax on this unrelated income. The impact of this non-profit competition has been devastating to many for-profit hearing aid dispensers. Some dispensers have closed offices; others are just hanging on. For-profit business cannot compete with low ball pricing of nonprofits that may not pay Federal Income Tax, State Income Tax, Sales Tax on services(where appropriate), Property Tax and they are also exempt from Unemployment Compensation contributions.

Hearing aid dispensers in Wisconsin would not have a problem with hospitals dispensing hearing aids for the convenience of their patients; by this we mean inpatients. My members object to the hospitals promoting their hearing aid dispensing business to the general public as an outpatient service and not paying any State Income Tax on this unrelated income.

The clarification I need is how the Department of Revenue is going to interpret the word patient. We would hope only inpatient hearing aid sales would be tax exempt and hearing aids sold to outpatients would be taxed as unrelated business income! Thank you!

Sincerely,

James a. Bohren

James A. Bohren
Certified Hearing Aid Audiologist
Board Certified (NBC-HIS)

President
WI. Alliance of Hearing Professionals

Wisconsin Merchants Federation

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February 2, 1988

State Senator William Te Winkle
136-S State Capitol
Madison, WI 53702

Dear ~~Senator Te Winkle~~ Bill:

Jim Bohren's letter of January 28 to you in support of Governor Thompson's proposal to tax unrelated busines income is on point. We continue to see concern grow about unfair non-profit competition. One of the most recent events in Wisconsin that triggered an outpouring of resentment was the Marshfield Clinic's new non-profit tax status arising out of a dispute over property tax payments (see attached).

Mr. Bohren's concerns regarding "out patient" unrelated income is also in last fall's recommendations arising out of the U.S. House of Representatives Ways and Means Committee hearings (see attached item #8). Finally, I've also attached a copy of an article on non-profit competition which appeared in INC magazine. It underscores the unfairness of non-profit competition and the political difficulties facing those who seek to remedy the problem.

The governor's proposal to federalize Wisconsin's tax code as it relates to non-profit business activities is an important step. We hope that you will support it and consider addressing the "outpatient" problem as well.

Thank you for your continued interest.

Respectfully yours,

Douglas O. Johnson
Vice President

cc: Governor Tommy Thompson
Department of Administration Secretary Klauser
Department of Revenue Secretary Case
State Representative Calvin Potter
State Representative Wilfrid Turba
Mr. James Bohren
Mr. Bill Smith, NFIB

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January 20, 1988

James A. Bohren
Beltone Hearing Aid Service
1033 North 8th Street
Sheboygan, WI 53081

Dear Jim:

Thank you for sending me the article on Marshfield Clinic going non-profit to become tax exempt. I have to agree with you that this situation could get entirely out of control and have a terrible impact on the taxpayers of Wisconsin. Should it happen in Sheboygan it would be devastating.

I fully realize what the impact would be on our taxpayers and it would be ludicrous to allow this to happen in our city.

Thanks again for the information.

Sincerely,

Dick

Richard J. Schneider
Mayor

RJS/jg

State of Wisconsin • DEPARTMENT OF REVENUE

125 SOUTH WEBSTER STREET • P.O. BOX [illegible] • MADISON, WISCONSIN 53708 • [illegible]

Tommy G. Thompson
Governor

Karen A. Case
Secretary of Revenue

Mark D. Bugher
Deputy Secretary

James R. Behrend
Executive Assistant

October 20, 1987

Mr. James A. Bohren
Beltone Hearing Aid Service
1933 North 8th Street
Sheboygan, WI 53081

Dear Mr. Bohren:

Senator Te Winkle has asked me to respond to your letter concerning competition between tax exempt and taxable commercial enterprises. As you are aware, this issue is receiving increased attention at both the federal and state levels.

When I last wrote to you in May, I noted that the Governor's Local Property Tax Relief Commission was considering a proposal to require in-lieu of tax payments or municipal service fees for exempt property owned by nonprofit organizations. As you may know, the Commission did approve of a proposal to allow municipalities to impose a fee on owners of exempt property.

Several organizations at the federal level are examining the competition between taxable and tax-exempt organizations. A recent study of particular relevance is the General Accounting Office's report entitled "Competition Between Taxable Businesses and Tax-Exempt Organizations."

As you may be aware, the federal government taxes the "unrelated business income" of tax-exempt organizations. The regulations which determine which income constitutes unrelated business income are quite complex. Internal Revenue Service Publication 598, "Tax on Unrelated Business Income of Exempt Organizations," discusses this issue in some detail. Copies of this publication can be obtained from the Internal Revenue Service. In contrast, Wisconsin does not tax the unrelated business income of tax-exempt organizations.

Real estate property tax exemptions are described in section 70.11 of the state statutes. Nonprofit hospitals are exempt under section 70.11(4m). If a portion of an otherwise exempt property is used for pecuniary profit, the part used for profit can be taxed under section 70.11(8).

Please be aware that the Department of Revenue does not grant property tax exemptions. If the owner of the property feels the property qualifies for the exemption, the owner submits an application for exemption to the local assessor. The decision on whether the property actually qualifies for an exemption rests with the assessor but can be challenged in state courts.

The issue of competition between tax-exempt and taxable businesses ultimately rests on the statutory definition of what constitutes "unrelated business income" for nonprofit organizations. The Department will endeavor to remain informed on action by the Congress in this area.

If I can be of further assistance on this matter, please feel free to contact me.

Sincerely,

Karen A. Case

Karen A. Case
Secretary of Revenue

KAC:DH:bm

cc: Senator Te Winkle

R2354289

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United States Senate
COMMITTEE ON APPROPRIATIONS
WASHINGTON, DC 20510-6025

September 9, 1987

Mr. James A. Bohren
Certified Hearing Aid Audiologist
Belton Hearing Aid Service
1933 North 8th Street
Sheboygan, Wisconsin 53081

Dear Mr. Bohren:

Many thanks for sending me a copy of your letter to Mr. Robert Leonard regarding the abuses of tax-exempt status by non-profit organizations. I regret the delay in my response, but I wanted to be certain you received a personal reply.

I can understand your concerns about this matter. The misuse of tax-exempt status by non-profit establishments could force many small, tax-burdened firms out of business. Organizations should not be able to capitalize on their non-profit status at the expense of tax-paying businessmen. I will keep your thoughtful suggestions and strong views in mind should the Senate consider any legislation which would regulate the actions of non-profit organizations more carefully.

Again, thank you for your comments. Please continue to keep in touch.

Best regards,

Robert W. Kasten, Jr.

RWK/mls

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March 2, 1988

United States Senator William Proxmire
SD 530 Senate Office Building
Washington, DC 20510

Dear Senator Proxmire:

We ask you to support efforts to address unfair competition by nonprofit organization. Unfair competition from nonprofit organizations has gained increased attention both in Wisconsin and in Washington. Out of over 400 issues before the Governor's Conference on Small Business held last fall in Madison following seventeen state regional meetings, the issue of unfair nonprofit competition ranked #8 (see attached handout). In Washington at a similar conference held in 1986 the issue ranked #3. In June of 1987 the House Ways and Means Committee held a hearing on the subject of unrelated business income tax and commercial activity by nonprofits.

The concern about unrelated business activities of nonprofits is widespread. It ranges from health clues to hearing aid sales from restaurants to laundries. If tax free, nonprofit organizations are allowed to unfairly compete with private business and if such actions ultimately force taxpaying businesses out of business, who then will pay the taxes necessary to support our government and its programs?

Thank you for your support.

Respectfully yours,

Douglas Q. Johnson,
Vice President

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Tommy G. Thompson
Governor

Karen A. Case
Secretary of Revenue

John W. Torgerson
Deputy Secretary

Mark D. Bugher
Executive Assistant

May 19, 1987

Mr. James A. Bohren
Beltone Hearing Aid Service
1933 North 8th Street
Sheboygan, WI 53081

Dear Mr. Bohren:

Thank you for your recent letter to Governor Thompson concerning the tax status of nonprofit organizations. Your letter raises several points which are receiving serious consideration both at the state and federal level.

The issue of property tax exemptions for nonprofit organizations is currently under study by the Governor's Local Property Tax Relief Commission, of which I am a member. The Commission is currently studying a proposal to require in-lieu of tax payments or municipal service fees for property owned by nonprofit organizations.

The department is also monitoring events in Congress concerning the taxability of nonprofit organizations for federal income tax purposes and the definition of what services and products nonprofit organizations can legally provide. Any tax law revisions enacted by Congress in this area will be reviewed by the state Legislature, which must decide whether or not to incorporate the revisions into the Wisconsin tax code.

If I can be of further assistance on this matter, please feel free to write to me.

Sincerely,

Karen A. Case

Karen A. Case
Secretary of Revenue

KAC:brm

cc: Governor Tommy Thompson
Lt. Governor Scott McCallum
Senator Russell Feingold
Senator William Te Winkle
Senator Donald Stitt
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April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Leonard

It is my understanding Representative Pickle has released the preliminary report of the House Ways and Means Oversight Subcommittee regarding reform of the Unrelated Business Income Tax (UBIT) laws.

Four years ago I invested a quarter of a million dollars in an expansion of our Hearing Aid Center in Des Moines, making it one of the best in the nation. Soon afterwards an United Way of Central Iowa agency built a half million dollar building for the purpose of selling hearing aids for profit in direct and unfair competition with us. In addition, the United Way of Iowa is subsidizing their hearing aid sales business annually with money given as tax-deductible gifts.

Hopefully your Subcommittee will recognize the unfairness of 501 (C)3 tax-exempt organizations being allowed to sell their hearing aids to any person, regardless of need, without following the same rules we must follow.

One and one-half years ago the Easter Seal Society of Sioux City started their for profit hearing aid business. Again, please give us equal laws under which we can compete fairly! We are not asking for favoritism - only an equal chance!

Sincerely

Paul E. Woodard

Enclosures (2)

Paul E. Woodard
Director, Hearing Aid Services

Leslie A. Whippen, M.S. CCC
Director, Audiology Services

Susan E. Schmiechen, M.A. CCC
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(Continued Next Page)

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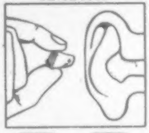

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April 8, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Subject: Comments - Oversight Subcommittee "Discussion Options"
Unrelated Business Income Tax (UBIT)

Dear Mr. Leonard,

Nonprofit competition is an extremely serious problem to the independently owned commercial laboratories in this country. We are counting on the Subcommittee recommending significant legislative reform to correct the current gross inequities relative to our nonprofit competition.

Our firm regularly competes with any number of university laboratories (or their staff members utilizing university facilities) offering product testing services in the nutrition and food/feed safety areas. These nonprofit organizations normally offer such services at substantially unfair pricing reflecting the cost economies of being exempt from taxation imposed upon the commercial laboratories. This situation is steadly worsening as the non profits are obviously viewing themselves as immune from reproach by the private sector as they aggressively expand their untaxed commercial enterprises.

One good example is the University of Georgia at Athens which in the past included a legend on their sample submission forms that stated "the information obtained from this sample is for educational purposes and is not intended to replace a quality control or research & development program...". The pretense of maintaining this facade has disappeared in recent years by the elimination of this legend from the sample submission forms, by the publishing of fee schedules for services which are often at 50% of fair market value and by their blatant advertising. One (former) client of this firm operating multiple plants around this country submits their samples directly to Athens through their Atlanta facility to take advantage of this bargain from the University of Georgia funded by the U.S. Treasury and the taxpayers of Georgia (our lab operates a branch in Georgia). This example is not isolated by any means - the University of Mississippi is almost as bad-as is Georgia Tech, the University of Alabama, and many other similar institutions. The University of Missouri expends funds to have their professors travel to national technical conferences passing out their fee schedules for commercial testing for basically tax-exempt commercial services. I firmly believe that no

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nutrition oriented commercial laboratory could survive in the state of Missouri. North Carolina's Clemson, at least, is somewhat more shielded in their offerings. Commercial services are obtained by making "donations" or "grants" in specified amounts for commercial laboratory services. Such offerings from the land grant schools have surpassed the bounds of any degree of reason. Many other schools, federally and state funded, make exceptionally good usage of taxpayer provided facilities, equipment and often labor to offer commercial services. There is sometimes the pretense of a professor, or a group of professors, paying the institution for the use of such resources-at let us say- considerably less than the fair market value to conduct that business. I have yet to find a case where individual professor's salaries were lowered to reflect the time they spend in such enterprises. One of my favorite examples of this is conducted by the Head of the Chemistry Department at Missouri State Western College.

We all agree that the Universities have their proper role in various aspects of research and development and related activities which are truly for educational purposes; but this could not possibly include commercial product testing! How can we seek relief except through testifying at such opportunities such as that provided by the Oversight Committee last June? Our entire industry is typically privately held small businesses without the resources to match the massive (tax payer funded) lobbying efforts of the nonprofits. Not only is it unreasonable that such commercial activities not be taxed the federal level, but such action would be a large step forward in allowing the various states and municipalities to also start to receive their fair share of taxation of these "not-for-profit" entities.

This brings me to the "discussion option" to "modify" taxation rules applicable to organizations "testing for the public safety". This option should be unequivocally deleted. There are several thousand well-qualified commercial testing laboratories in this country serving virtually every need for product commercial testing. Most of these private laboratories have qualified for and maintain numerous governmental, industry or society certifications applicable to serving their client base. The private labs are often far more qualified to serve as a competent testing facility than are many of the universities/other nonprofits who are deviating from their charter. The independent laboratory community would be the first to say that business status is never a substitute for technical competence. The facts are that there is little to no known need for university/nonprofits conducting "testing for the public safety". This phraseology could well include the entirety of the commercial work performed by this firm for it's clients. I request that you do not leave this totally unacceptable "door" open to our not-for-profit competitors as an exception to being fairly taxed for their commercial activities.

Our national deficit is entirely too high to allow the continuation of this grossly imbalanced situation with regard to taxation. We in private industry will happily compete with anyone, but let's put us on the same footing by rightfully taxing such unrelated revenues of the nonprofit organizations. Thank you for your consideration.

Very truly yours,
WOODSON-TENENT LABORATORIES, INC.

Ned McCarthy

Ned McCarthy
President

cc: American Council of Independent Laboratories
Representative Harold E. Ford
Senator Jim Sasser

Woodson-Tenent Laboratories, Inc.

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13 April 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Sir:

As Director of the Worcester Art Museum I am very concerned about options for changing the unrelated business income tax (UBIT). Recent tax law changes have significantly reduced incentives for charitable contributions of cash, stocks, and art objects to museums. The impact of these changes has not yet been fully understood or analyzed. With declines in governmental support as well as charitable giving, earned revenue is one of the few income streams that cultural institutions can rely upon to balance their budgets in an increasingly complex and competitive environment. The taxation of non-profits revenue producing activities would pose a major threat to the fiscal stability of museums.

Specifically, the proposed option to tax on-premises sales with a few exceptions would be very damaging, not to mention that it would be a reporting nightmare. The Worcester Art Museum takes great care that every item sold in the Museum Shop be related directly to our collection or to other museum collections, and that all items are of an educational nature. Taxing general art history books while exempting publications of a museum's own collections would create an undue burden for smaller museums, since they have more limited resources for publication, while the major museums have well-developed publications programs. The option of taxing off-premises sales would be less cumbersome to administrate, but would still be very damaging to museum revenues.

Repeal of the convenience exception would also be very damaging. Taxation of income derived from operating a museum cafe, for example, would result in closing of many facilities in small to mid-sized museums, where dining facilities are often subsidized as a service to members, and very few break even.

I feel strongly that these proposed changes in the unrelated business income tax would be disproportionately damaging to smaller cultural institutions and would eliminate one of the few avenues still available for non-profits to be self-supporting and less reliant on government subsidy and charity.

Cordially,

Patricia A. Doran

Patricia A. Doran
Director of Administration and Planning

PAD/b

YALE UNIVERSITY ART GALLERY

13 April 1988

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I call upon your ear in comment to "the issue of taxation of non-profits' revenue-producing activities." As coordinator of a museum store I feel threatened by the potential damage to many museums inherent in the proposed over-all changes in taxation.

At the Yale Art Gallery the Art Gallery Shop focuses on art books, catalogues, paper products, jewelery and gifts. Some of our merchandise has been developed from the collections while a percentage is purchased from the trade market. Nevertheless, I feel that an effort is made to work within the constraints of our non-profit status, thereby ensuring that our merchandise is substantially related to the Yale Art Gallery collections. To narrow our merchandise from from substantially related to directly related would alter the course of museums.

Museum stores have, perhaps, become rather inherently commercial, yet, they exist (or should) for their institutions. At Yale all purchases in the Art Gallery Shop help support the ongoing programs and nearly 15 exhibitions each year. As well, the Art Gallery Shop extends a generous discount to the Yale community which represents a considerable portion of New Haven. Application of taxation on gift shop, bookstore and royalty sales as noted under Discussion Options: (I) Substantially Related Standard would diminish greatly needed funds. I urge you and your colleagues to consider carefully the proposed harm to non-profit institutions.

I am yours,

sincerely,

Howard el-Yasin
Coordinator
Art Gallery Shop

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April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg
Washington, D.C. 20515

Dear Mr. Leonard:

I am writing as a Museum Store professional to protest the recently suggested options in changing the tax on unrelated business income as it applies to Museum Stores. I do not have to remind you of the deep cuts in available funding for non-profit organizations, but it is worth pointing out to those who appear to have missed the point that retail operations such as Museum Shops provide needed income so that we may continue to serve the public with programs which enrich our visitors' cultural lives, further their education and provide families with activities which are important in further stimulating children's curiosity about our world.

Of course, I do believe that we should respect certain guidelines on the nature of our merchandise. Nearly all Museum Stores are already complying willingly with existing standards; selling merchandise which is substantially related to our exempt purpose. This makes perfect sense and many Museum Store buyers, myself included, have set standards which exceed the IRS guidelines. However, the extreme changes suggested by your discussion options would severely restrict our ability to both produce needed income for our institutions and serve the public.

One example which I feel particularly shows how senseless are some of these discussion options is the suggestion that a UBIT be applied to a general art history book sold at a Museum Store. On what grounds would this be done? Is it not directly related to that museum's exempt purpose: to preserve and exhibit works of art for the enjoyment and education of the public? How could anyone say that a survey of the history of art, or any book dealing with any period of art is not directly related to any collection of art? I feel this is misguided at best.

Please consider carefully the impact these options could have on our nation's very deserving and needy institutions, already doing a good job of staying within current strict standards for relatedness of retail operations.

Thank you for your consideration.

Sincerely,

Jane Krieger
Museum Shops Manager

YMCA OF THE USE COMMENTS ON THE OPTIONS FOR CHANGES IN THE UNRELATED BUSINESS INCOME TAX (UBIT) RULES

April 15, 1988

Honorable J.J. Pickle, Chairman
Oversight Subcommittee
House Committee on Ways and Means
1105 Longworth House Office Bldg.
U.S. House Of Representatives
Washington, D.C. 20515

Dear Congressman Pickle:

I am writing on behalf of the YMCA of the USA in response to your request for comments on the options for changes in the unrelated business income tax (UBIT) rules contained in your March 31, 1988 press release. Before commenting on the substance of the options, let me say we very much appreciate the careful and deliberate manner in which you and the subcommittee are conducting this review of the UBIT rules, and thank you for this opportunity to comment on the options under consideration.

As a member of the National Assembly of National Voluntary Health and Social Welfare Organizations and the Grants and Contracts Project, the YMCA of the USA has participated actively in preparation of the joint comments filed today by these groups. The National Assembly/GCP statement strongly urges the subcommittee not to endorse either of the suggested alternatives to the "substantially related" test, and also addresses a number of the more specific options on the subcommittee's list. I will not repeat those comments here. However, I do urge the subcommittee to give careful consideration to each of the points raised in their comments, with which the YMCA of the USA fully concurs.

I will focus my comments, instead, primarily on the option of most direct importance to YMCAs -- that dealing with the UBIT treatment of income from "health, fitness, exercise and similar activities." As stated in your press release, this option would subject such income to UBIT unless "the program is available to a reasonable cross-section of the general public such as by scholarship or fees based on community affordability."

YMCAs are committed to the principle of "community affordability" in all of our programs and facilities. Inclusiveness is a fundamental aspect of YMCAs' community service mission, and one that clearly distinguishes our adult fitness programs from those operated by commercial concerns. Accordingly, we endorse the proposed "community affordability" standard as an appropriate basis for determining the continued tax-exemption of YMCA fitness programs. I fully expect that the many YMCAs around the country actively concerned about this issue will likewise support the "community affordability" standard.

In endorsing this standard, I would point out that it is a more stringent rule than applied to many other activities exempt from tax under section 501(c)(3). For example, the income of performing arts organizations, educational institutions, and hospitals is currently exempt from UBIT, and would remain so under the subcommittee's options, regardless of whether the activities generating this income meet a "community affordability" test. Notwithstanding this fact, YMCAs willingly accept the "community affordability" standard for our programs.

As with any new tax law standard, the practical impact of the "community affordability" rule will depend significantly on how the general concept is translated into statutory language and explained in the subcommittee's report. We sincerely hope that we will continue to have the opportunity to work with you, the subcommittee, and its staff through these further steps in the legislative process.

In closing, let me raise a more general concern about the press release's use of the term "inherently commercial" to describe the various activities -- including health and fitness programs -- for which Section I of the press release proposes more specific UBIT rules. Each of the proposed rules can, and in our view should, be viewed as simply clarifying the application of the "relatedness" standard to the activities in question. However, some critics of nonprofits are already hailing the use of the phrase "inherently commercial" as signalling a significant step away from the relatedness test toward a general "commerciality" standard for loss of tax exemption. Our impression, based on contacts with subcommittee members, is that the subcommittee does not intend such a fundamental change in the UBIT framework -- a change which would create major uncertainty as to the tax treatment of nonprofit activities far beyond those specifically addressed in the press release. Therefore, we would strongly urge deletion of the phrase "inherently commercial" in characterizing the specific activities addressed by the subcommittee's proposals.

Thank you for your consideration of these comments.

Sincerely,

Robert A Boisture

Robert A. Boisture
Associate General Counsel
YMCA of the USA

Young's HEARING AID SERVICE

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COLUMBIA, S. C. 29202
TELEPHONE 254-7888

800 PENDLETON STREET
GREENVILLE, S. C.

1607 BRABHAM AVENUE
COLUMBIA, S. C.

April 12, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1101 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

Thank you for your time and committment on the study of the problem of unfair competition in the field of hearing aid dispensing. This is a most welcome study as these non-profit organizations appear to be false labels. This existing problem may have started out as minor but has grown in proprotions and in time will snuff out the free enterprise system. There are Hospitals, non-profit Speech and Hearing Centers as well as other institutions using our tax money, yet still receiving tax deductible donations. With these advantages, they can turn around and competite with the businessman in the hearing field by cutting the sales price. This existing problem will eventually put the hearing aid specialist out of business as we have to pay for overhead expenses out of our own pockets. Truthfully speaking, I don't feel it is fair for me as a taxpayer to be required by law to give my competitors who in turn can put me out of business.

Any institution or organization receiving tax deductible contributions or tax money should not be allowed to compete with other commercial businesses unless their donations are taxed, they to be required to pay rent, pay for their equipment, salaries and all this be deducted from their icnome profit off the sales of hearing aids. Perhaps the easier thing to do would be for them to refrain from any commercial activity. Here in the State of South Carolina, we have the Speech and Hearing Centers, the Medical University and hospitals who are dispensing hearing aids and at prices that we as commercial hearing aid dispensers just cannot competite with in order to be able to make a living.

As to the "in-patient" who is in need of hearing aids, I do not feel special consideration should be given them as we Hearing Aid Specialist are qualified licensed dispensers and capable of fulfilling their needs as well as the non-profit organizations.

I sincerely hope you will please be sure to apply UBIT to all hearing aid sales income of nonprofits. Any help given to this problem will be appreciated.

Yours truly,

G. Charles Young
GCY/mh
cc Mr. Pickle
Mr. Floyd Spence

Young's HEARING AID SERVICE

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April 11, 1988

Robert J. Leonard, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1101 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

Please allow me this opportunity to thank you for your time and committment given to the study of the existing problem of unfair competition in the field of hearing aid dispensing. This study is indeed most welcome. These so called non-profit organizations are nothing but false labels. While this problem may have started out as minor, it has become an ever-increasing "snowball" which will in time ultimately kill the free enterprise system. Hospitals, non-profit Speech and Hearing Centers as well as other institutions are using tax money and still receiving tax deductible donations. They then turn right around with these advantages and cut my price on sales as I am not entitled to their benefits. The growth of this problem has been on the increase for quite some time and I can no longer compete with these institutions. This existing problem will eventually dry up the hearing aid specialist as we naturally have to pay for overhead expense out of our pockets while they do not. If they are allowed to continue this unfair practice, this will reduce their competition and allow them the opportunity to drive up their fees. It is not fair for me as a taxpayer to be required by law to pay my competitors to in turn put me out of business.

There is no need for special consideration to be given for In-patient's who need hearing aids as the Hearing Aid Specialist are qualified and can in turn fulfill their needs as well as the non-profit organizations.

Any institution or organization that receives tax deductible contributions or tax money should not be allowed to compete with other commercial businesses unless their donations are taxed, they be required to pay rent for their offices, pay for their equipment, staff salaries and all this be deducted from their income profit off the salesa of hearing aids. The simplest thing for them would be to refrain from any commercial activity. Here in the State of South Carolina, we have the Medical University, Speech and Hearing Centers as well as Hospitals who are dispensing hearing aids and at prices below what we the commercial hearing aid dispensers can sell hearing aids in order for us to be able to exist.

Please be sure to apply UBIT to all hearing aid sales income of nonprofits. Any help given to this problem will be greatly appreciated.

Sincerely,

John H. Young

John H. Young, Jr.

JHY/mah
cc Mr. Pickle
NHAS

YOUNG WOMEN'S CHRISTIAN ASSOCIATION

YWCA — 211 LAKE STREET — ELMIRA, NEW YORK 14901-3193 — 733-5575

April 14, 1988

Hon. J.J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Bldg.
Washington, D.C. 20515

RE: Discussion Options and UBIT

Dear Congressman:

The YWCA of Chemung County (Elmira, NY) is a relatively small organization which most likely would be burdened by some of the proposed options to the UBIT. For our organization and simiar organizations, the following concerns stem from your release of March 31, 1988. (Attachment A):

I. Is it worth the time and effort on the part of our bookkeeper, CPA, and/ or an IRS auditor to go through the procedures of a "directly related" test for a small agency such as our YWCA?

II. (C) (E). Additional paperwork for an agency such as ours in documenting income from health and fitness related activities, or even from documenting memberships, fees, scholarships, and community affordability could be a burden.

We do not believe that our agency would be financially hurt by the proposals, but are concerned about more unneeded paper work.

Very truly yours,
YWCA of Chemung County

Geo F. Murphy

George F. Murphy
Development Coordinator

jlc

MEMBER YWCA OF U.S.A. · WORLD YWCA · UNITED WAY OF CHEMUNG COUNTY

YWCA OF LOS ANGELES
SERVING LOS ANGELES SINCE 1894

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Executive Director

April 14, 1988

The Honorable J. J. Pickle, Chair
Subcommittee on Oversight, Committee
on Ways and Means
Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Pickle:

We have just received word of the request for public comment on discussion options relating to the Unrelated Business Income Tax. We have neither the staff, the volunteers, the money, the expertise nor the time to analyze, evaluate and respond to each of the options listed in press release #16 of your Subcommittee.

Therefore, we turn to you and your colleagues to thoughtfully and carefully protect the health and survival of the hugely divergent spectrum of charitable 501(c)3 organizations in this country. We are cognizant of the concern of small business interests who do not want non-profit competition. What is so ironic is that in instance after instance, the "businesses" were pioneered by charitable organizations to meet human needs not addressed by the for-profit world, i.e., hospitals, child care, health and fitness facilities, thrift shops, etc.

As government increasingly withdraws from meeting social needs, we must sustain the viability of the charitable organizations to whom society turns to meet those needs. It is an overwhelming burden. If by some fortuitous planning and work, we are able to make money above our costs, that money is plowed back into services to the needy who cannot pay full cost. We cannot believe that, for example, the annual Girl Scout cookie sale, tax free, has such a negative impact on the for-profit stores in a community that Girl Scouts should be taxed in order to "equalize" the load.

We urge you to evaluate every single option under the UBIT and determine who really benefits? and evaluate, is this for the overall public good?

Thank you for your thoughtful consideration of our request.

Sincerely yours,

Sandra Jones Anderson
(w)

Sandra Jones Anderson
President

SJA:hh

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Executive Director
Gwendolyn Calvert Baker

April 15, 1988

Hon. J.J. Pickle, Chairman
Oversight Subcommittee
House Committee on Ways and Means
1105 Longworth House Office Building
Washington, DC 20515

Dear Representative Pickle:

The YWCA of the USA, a national women's membership movement with programs that serve over 5 million women and their families in over 3,000 communities, thanks you for this opportunity to comment on the Oversight Subcommittee's options for changes in the unrelated business income tax.

As a multi-program human service agency, the YWCA would be affected in a number of ways should the proposed changes become law. Our comments here, however, must remain brief as we have not had the opportunity to fully assess the potential impact of the proposed changes.

The YWCA urges the Subcommittee to retain the current "substantially related" test for determining when unrelated business income exists, and hopes that the Subcommittee will abandon its characterization of listed activities as "inherently commercial." The YWCA engages in many of the activities cited in the Subcommittee press release, but in all important respects, YWCA programs are fundamentally different from similar activities carried on in the for-profit sector. For example:

o YWCA health and recreation programs are motivated by a mission to provide a comprehensive program that fosters healthy emotional and physical development. YWCA health and recreation programs make a special effort to serve those who because of financial situation, age, or handicap have limited access to other types of facilities. The YWCA is absolutely committed to the principle of "community affordability," a commitment that distinguishes us from commercial efforts. We consequently must strongly disagree with the characterization of all health and recreation activities as "inherently commercial."

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- The YWCA of the USA sponsors international study programs in which small groups of women visit such places as the Middle East and the Soviet Union for in-depth study (including seminars and visits to the countries' YWCAs) and dialogue. These programs are not recreational; it is our belief that such programs foster international peace and understanding. We therefore cannot endorse a framework that would classify these activities as "inherently commercial."
- YWCA member Associations frequently offer travel opportunities to the elderly and handicapped. We view these activities to be related to our charitable mission and in no way "commercial," because their purpose is to dispell the loneliness and isolation that often accompany old age or handicapping condition.
- YWCA travel programs rarely yield a surplus. In cases where a surplus does occur, it is frequently because a volunteer has donated her time to the activity, thereby reducing costs attributable to staff time. Consequently, taxing such an activity would, in effect, be taxing a donation -- a result which we are certain is outside the ambit of the Subcommittee's intent.

With respect to the balance of the Subcommittee options, the YWCA of the USA concurs with the comments submitted by the Grants and Contracts Project, of which we are a member.

Thank you again for this opportunity to comment. We look forward to working with the Subcommittee in its effort to achieve a fair and equitable unrelated business income tax law.

Sincerely,

Gwendolyn Calvert Baker

Gwendolyn Calvert Baker
National Executive Director

GCB:nh